“The Ownership Society”: Mortgage Securitization and the Metropolitan Landscape Since the 1960s

by

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Abstract

"The Ownership Society" examines the residential mortgage system in the United States from the 1960s through the 1980s, focusing on questions of policymaking and political economy at the local, state, and national levels. Under the New Deal home finance system, highly regulated, government-supported thrift institutions and banks originated and retained mortgages within legally circumscribed regions. For the financial elites who controlled these institutions, mortgages created a set of economic and political imperatives grounded in the financial viability of local real estate markets and the specificities of place. Confronted with credit crunches in the mortgage market during the late 1960s, a coalition of finance executives and Johnson Administration policymakers searched for new sources of capital for mortgages. The efforts of these growth liberals culminated in the 1968 Housing and Urban Development Act. This legislation created a new financial instrument called the "mortgage-backed security" (MBS) and charged federal housing agencies and government-sponsored, privately owned corporations with generating the MBS market. MBSs transformed concrete, illiquid mortgages into abstract, liquid securities that represented investments in neither specific mortgages nor local real estate markets but rather massive pools of mortgages from across the country. Created, sustained, and guaranteed by the federal government, MBSs subsumed local circuits of capital, dominated by place-bound financial institutions—most importantly thrifts—into national and international circuits of capital, dominated by Wall Street financiers. Government mortgage corporations redirected capital from slow-growth regions, particularly the Rust Belt, to high-growth regions,

especially in the Sun Belt. In places such as Los Angeles and Houston, mortgage securitization fueled speculative homebuilding booms on the metropolitan periphery. Meanwhile, volatile interest rates during the 1970s and 1980s along with financial deregulation and industry consolidation devastated the local thrift industry. Grassroots homeowner groups fought the decline of federally regulated financial localism. However, policymakers increasingly saw the MBS market as the future of home finance. By the end of the 1980s, the MBS market had displaced the New Deal system as the dominant source of mortgage capital in the U.S. Securitization significantly increased systemic risk and volatility within the mortgage market, ultimately leading to the Crash of 2008.

Introduction

In February 1968, President Lyndon B. Johnson sent a special message to Congress on the "crisis of the cities." America's cities, he said, were in decline. City-dwellers were "trapped by a wall of prejudice, denial, and lack of opportunity." Poverty, unemployment, crime, and "shameful" housing conditions fueled frustration and violence. "The cry of the city," he said, "is the cry of a man for his sense of place and purpose." According to Johnson, homeownership was central to solving the crisis. He called for sweeping new legislation, the 1968 Housing and Urban Development Act, "a charter of renewed hope for the American city." He claimed that it would inaugurate a "new era in home financing." Traditional home lenders, namely local banks and thrift institutions, could not provide enough money to meet homeownership goals, the president explained.[1] Thus, the act would create federal programs that would provide new sources of capital to the mortgage market, such as pension funds, private trusts, and individual investors. The 1968 Housing Act would set in motion a transformation of the home finance system over the following two decades.

Not everyone agreed that the "new era in home financing" promised "renewed hope for the American city." In 1974, a Chicago homemaker named Mary Lou Wolff testified before Illinois state legislators about growing inequality in the home finance system. New techniques of mortgage lending, promoted by the 1968 Housing Act, led to the systematic "disinvestment of

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[1] Lyndon B. Johnson, "Special Message to the Congress on Urban Problems: 'The Crisis of the Cities,'" Feb. 22, 1968, *Public Papers of the Presidents: Lyndon B. Johnson 1968-1969* (Washington, DC: Office of the Federal Register, National Archives and Records Service, General Services Administration, 1970), 253.

mortgage funds from… older [urban] neighborhoods," she claimed.[2] Wolff was president of a working-class, grassroots homeowner group called the Citizens Action Program (CAP). CAP argued that local financial institutions, particularly thrifts, should remain the nation's primary source of mortgage funds. These institutions should use local savings accounts to fund local mortgages, according to CAP activists. Wolff and CAP believed that the decline of financial localism would lead to growing patterns of discrimination and disinvestment.

By the 1990s, an international mortgage-backed securities market had replaced the local thrift association as the nation's primary source of mortgage capital. With Wall Street money flowing into the mortgage market, politicians promised that securitization could not only solve the "crisis of the cities" but also finance an unprecedented level of homeownership. In 2002, President George W. Bush hosted a White House Conference on Minority Homeownership. Bush articulated a grand vision of an "ownership society." "Owning something is freedom," he asserted. A society where everyone owned a home would be a "compassionate society."[3] Mortgaged homeownership, however, had drastically changed since 1968. Federally backed mortgages had become riskier, especially for lower-class and minority homebuyers—and the home finance system had become more complex and less transparent. When the housing market crashed in 2008, freedom and compassion seemed in short supply.

"The Ownership Society" begins in 1966 with the decision of the Federal Reserve to raise interest rates to postwar record levels in response to concerns about inflation. As a result, investors moved their money out of savings accounts into higher-yielding investments, such as Certificates of Deposit (CDs) and corporate stock—a process called disintermediation.

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[2] Mary Lou Wolff, "Forward Commitments Prove Wholesale Red-lining," *CAP Action*, Aug. 1974, "CAP Action Newsletter April 1971 - Winter 1975," Box 6, CAP - Booth, Chicago History Museum.
[3] George W. Bush, "Remarks at White House Conference on Minority Homeownership," Oct. 15, 2002, Online by Gerhard Peters and John T. Woolley, *The American Presidency Project*. http://www.presidency.ucsb.edu/ws/?pid=73152 (accessed Apr. 3, 2015).

Disintermediation had a disastrous impact on the mortgage market because thrift institutions, which included Savings and Loan Associations (S&Ls) and Mutual Savings Banks, funded a majority of the nation's mortgages by using capital from savings accounts.[4] The nation's reliance on thrift institutions for mortgage funds was a product of New Deal policies that subsidized the industry. As the nation entered a period of high and volatile interest rates, policymakers in the Johnson Administration worried that Americans would find it increasingly difficult to attain homeownership. Democratic populists in Congress, such as Representative Wright Patman, Chairman of the House Committee on Banking and Currency, and Senator Albert Gore, Sr., urged Johnson to openly confront the Fed over interest rates. The Johnson Administration, however, accepted the need for higher interest rates in order to maintain the U.S. Dollar's position as the world's dominant currency. Instead of directly challenging rising interest rates, the Administration decided to seek new sources of mortgage capital that were not as sensitive to interest rate volatility. They turned to a cohort of economists and mortgage bankers who argued that mortgages could be turned into financial securities, like stocks and commodities, and traded by a wide variety of investors, such as pension funds, investment banks, and private individuals.

The 1968 Housing Act, passed with overwhelming bipartisan support, gave birth to mortgage securitization. It also established the Government National Mortgage Association (Ginnie Mae), a government-owned corporation, and it reorganized the Federal National Mortgage Association (Fannie Mae). Previously a government-owned corporation, Fannie Mae became a privately-owned, for-profit corporation. However, the Act maintained significant government support for Fannie Mae, most importantly an implicit guarantee that the government

[4] Michael Ball, *Under One Roof: Retail Banking and the International Mortgage Finance Revolution* (New York: Harvester Wheatsheaf, 1990); and David Mason, *From Building and Loans to Bail-Outs: A History of the American Savings and Loan Industry, 1831-1995* (Cambridge: Cambridge University Press, 2004).

would not allow it to fail. Two years later, Congress established another government-supported, privately owned corporation, the Federal Home Loan Mortgage Corporation (Freddie Mac). These three institutions would carry out the mortgage securitization program.

President Johnson declared that the 1968 Housing Act was the beginning of a "new era in home financing," but he could not have imagined the extent to which securitization would transform the nation's home finance system. During the 1970s, interest rate volatility substantially increased.[5] Many thrift institutions suffered capital outflows that endangered their financial viability. In response, federal regulators decided that industry consolidation would mean a more resilient system, and they began to encourage mergers and acquisitions to produce larger financial institutions with greater capital reserves. They also removed restrictions on branching and relocation so that institutions could better capitalize on growth areas. As a direct result of this, grassroots homeowner movements challenged the move away from local thrift institutions as the guarantors of mortgaged homeownership. They saw local thrift institutions as public institutions that had special commitments to the communities they served. The savings accounts that they held were "the people's money," in the words of CAP.[6] Thrifts had been sending capital to the suburbs for decades and disinvesting from urban neighborhoods, especially African American neighborhoods and surrounding areas, but in the early 1970s, patterns of urban disinvestment were growing to include an increasing number white working-class communities. Consolidation, branching, and securitization severed the ties of mortgage capital to its

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[5] On the financial turbulence of the 1970s see Judith Stein, *Pivotal Decade : How the United States Traded Factories for Finance in the Seventies* (New Haven: Yale University Press, 2010), Bruce J. Schulman, *The Seventies: The Great Shift in American Culture, Society, and Politics* (Cambridge: De Capo Press, 2002); Daniel Rodgers, *Age of Fracture* (Cambridge: Belknap, 2011).
[6] "Redlining in Chicago," *CAP Action*, Jun. 1974, "CAP Action Newsletter April 1971 - Winter 1975," Box 6, CAP - Booth, Chicago History Museum.

communities. They made it easier for financial institutions to invest their money wherever the return was greatest instead of within their home communities.

During the 1970s, financial institutions increasingly sent their mortgage capital to high-growth areas, such as the outer suburbs of Los Angeles and Houston. Both suburban and Sun Belt favoritism had been a feature of New Deal mortgage policy.[7] Securitization intensified the capital flow from city to suburb by further standardizing mortgage appraisal processes that preferred new suburban construction in socially homogenous neighborhoods. Government-supported securitization also added to an array of federal policies that subsidized Sun Belt growth, which included spending on the defense industry, education, and infrastructure.[8] In the 1970s and 1980s, Fannie Mae and Freddie Mac purchased a vast majority of their mortgages in the South and West using capital from the North and East. For example, half of Freddie Mac's mortgage portfolio in 1976 was located in California, Texas, Colorado, Virginia and North Carolina. Meanwhile, it drew half of its capital to buy these mortgages from Illinois, New York, Ohio, Indiana, Minnesota and Michigan.[9] For a moment in the mid-1970s, homeowner groups succeeded in directing policymakers' attention to growing inequality in the mortgage market. But at the end of the decade, high inflation and interest rates created an unprecedented crisis in the finance system. Policymakers put aside questions of metropolitan and regional equity in

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[7] For federal policies that subsidized suburban development in the postwar housing market see, for example, Kenneth Jackson, *Crabgrass Frontier: The Suburbanization of the United States* (New York: Oxford University Press, 1985); and David Freund, *Colored Property: State Policy and White Racial Politics in Suburban America* (Chicago: University of Chicago Press, 2010).

[8] For Sun Belt subsidies see, for example, Carl Abbott, *The New Urban America: Growth and Politics in Sunbelt Cities* (Chapel Hill: University of North Carolina Press, 1981); Bruce J. Schulman, *From Cotton Belt to Sunbelt: Federal Policy, Economic Development, and the Transformation of the South, 1938-1980* (Durham: Duke University Press, 1994), Margaret O'Mara, *Cites of Knowledge: Cold War Science and the Search for the Next Silicon Valley* (Princeton: Princeton University Press, 2005); and Andrew Needham, *Power Lines: Phoenix and the Making of the Modern Southwest* (Princeton: Princeton University Press, 2014).

[9] Congressional Research Service, *The Role of the Federal Home Loan Mortgage Corporation in the Secondary Mortgage Market*, Dec. 8, 1976, 11-12.

order to address the effects of inflation and interest rates on the middle class. Skyrocketing interest rates and deregulation devastated the thrift industry in the 1980s.[10] Both Democrats and Republicans saw mortgage securitization as the future of home finance and passed legislation that further aided its growth. By 1988, about seventy percent of all new mortgages were securitized.[11] By 1990, Ginnie Mae, Fannie Mae, and Freddie Mac held 38 percent of total mortgage debt outstanding in the U.S.[12] Meanwhile thrifts' share of the market declined to 22 percent in 1990 (See Figure I.1). By 2008, thrifts held only 8 percent of outstanding mortgage debt.[13]

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[10] On the S&L crisis see, for example, Martin E. Lowy, *High Rollers: Inside the Savings and Loan Debacle* (New York: Praeger, 1991): Kitty Calavita, Henry N. Pontell, and Robert Tillman, *Big Money Crime: Fraud and Politics in the Savings and Loan Crisis* (Berkeley: University of California Press, 1997).
[11] Michael Ball, *Under One Roof: Retail Banking and the International Mortgage Finance Revolution* (New York: Harvester Wheatsheaf, 1990), 82.
[12] Heather MacDonald, "Secondary Mortgage Markets and Housing Policy," *Journal of Urban Affairs* 17:1 (1995), 57.
[13] James R. Barth, *The Rise and Fall of the U.S. Mortgage and Credit Markets: A Comprehensive Analysis of the Market Meltdown* (Hoboken, N.J.: Wiley, 2009), 350.

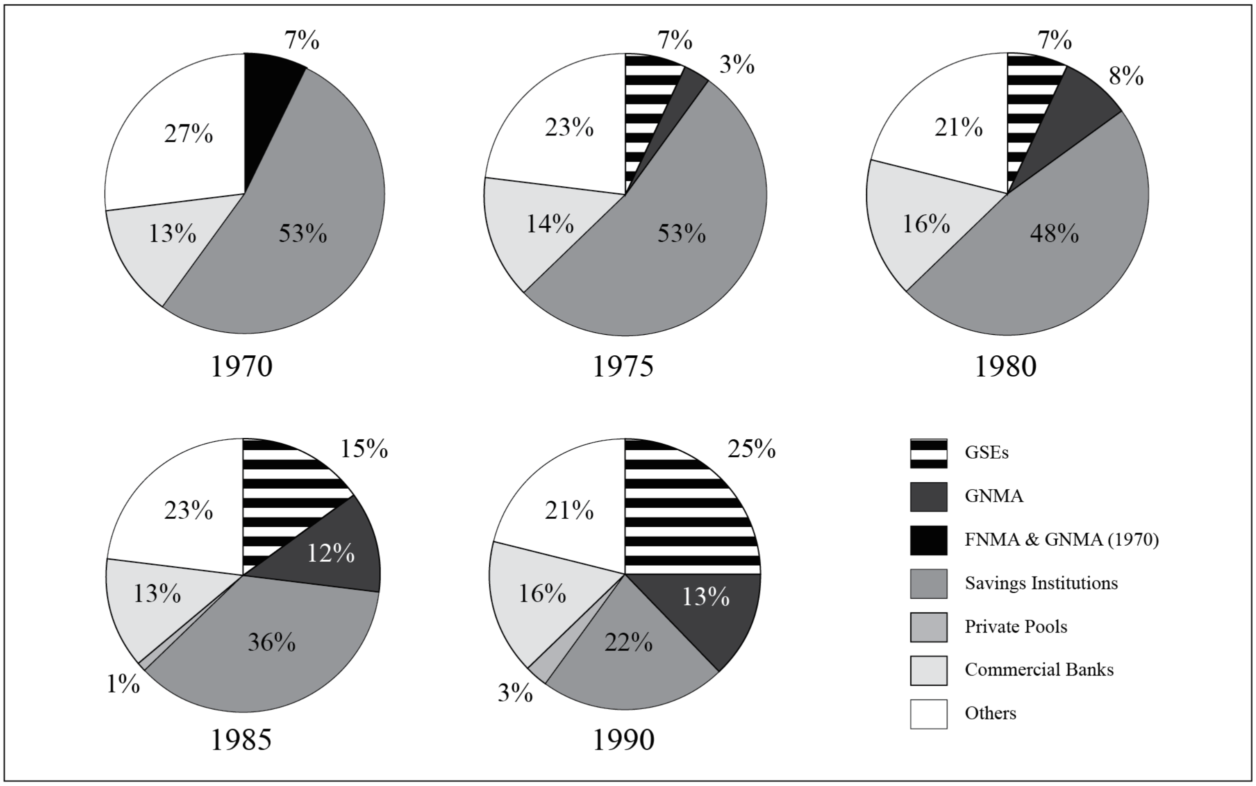

Figure I.1. Percentage of Total United States Mortgage Debt Outstanding by Type of Institution. Sources: Franklin H. Ornstein, Savings Banking: An Industry in Change (Reston: Reston Publishing Company, 1985), 303; Heather MacDonald, "Secondary Mortgage Markets and Housing Policy," Journal of Urban Affairs 17:1 (1995), 57. Note: "Others" include life insurance companies, pension funds, and private investors. "Private Pools" are mortgage pools not backed by GNMA, FNMA or FHLMC. "Savings Institutions" are S&Ls and Mutual Savings Banks.

The decline of thrift institutions and rise of securitization over the course of the 1970s and 1980s marked a shift from a New Deal Home Finance System to a Securitized Home Finance System. Three major political and economic differences distinguish the Securitized Home Finance System from the New Deal Home Finance System. First, the Securitized System drastically consolidated the structure of the home finance industry. It replaced the New Deal System's dispersed network of local thrifts with one dominated by large banks, Wall Street investment firms, and, most importantly, two privately owned but government-subsidized corporations—Fannie Mae and Freddie Mac. Fannie Mae had been a part of the New Deal

System, but the Securitized System gave it a significantly larger role. Second, the Securitized System increased risk, on both individual and systematic levels, and it also redistributed risk. To a greater extent than the New Deal System, the Securitized System decreased financial institutions' exposure to risk and increased homeowners' and the government's exposure to risk. Third, the Securitized System relied on a deepening alliance between growth liberals and large-scale finance. Politicians of both parties enacted policies that were beneficial to Wall Street, but growth liberals' role was crucial. As inheritors of the New Deal mandate of mass homeownership, they were persistent in their efforts to construct a government-subsidized apparatus for channeling Wall Street money into the mortgage market.

The continuities between the New Deal System and the Securitized System illustrate policymakers' persistent support for a nation of suburban homeowners. In both systems, politicians approved massive subsidies to financial institutions in the name of increasing homeownership. Furthermore, both systems facilitated capital flight from the city to the suburbs and, on a regional scale, from the North and East to the South and West. Government support for the mortgage market worked in tandem with numerous other federal subsidies for suburban growth, especially in the Sun Belt. And lastly, both systems discriminated against African Americans, Latinos, and other racial minorities. Throughout both eras, government policies favored segregation and urban disinvestment.

These continuities between the two systems are just as important and illuminating as the differences. They reflect the ability of the Securitized System to preserve many of the facets of the New Deal System within a rapidly changing political and economic context. In order for the home finance system to continue to ensure mortgage availability and facilitate suburban growth, policymakers recognized that significant reforms were needed. Beginning in the second half of the 1960s and drastically intensifying in the 1970s, inflation endangered New Deal thrifts' ability to provide mortgages and fund suburban growth, particularly in high-growth, Sun Belt cities. The Securitized System furnished policymakers with an alternative to the thrift system, one that could better maintain mortgage access during periods of high inflation and interest rates.

Similarly, the Securitized System was able to sustain the racial biases of the New Deal System just at the moment when the Civil Rights Movement was challenging such discrimination. The 1968 Fair Housing Act, which outlawed explicit, individual acts of racial discrimination in the housing market, coincided with the origins of securitization in the Housing and Urban Development Act of the same year. The Securitized System significantly reduced the power of local financial executives to decide where and to whom to lend. Instead, securitization hid racism behind a much more distant, opaque, and complicated network of institutional policy.

Securitization and the consolidation of the finance industry transformed the political economy of the home finance system. Securitization obscured the flow of capital and produced much more powerful financial institutions. Thus, it severely diminished the ability of grassroots movements to challenge patterns of disinvestment, regional favoritism, abusive subprime lending and redlining. Securitization's transfer of risk from financial institutions to homeowners and the government is part of what Jacob Hacker has called "the great risk shift" in the American economy in recent decades, whereby corporate risk has been socialized while individual risk has been privatized.[14] Ginnie Mae, Fannie Mae, and Freddie Mac, along with partners on Wall Street, developed complex new financial instruments that aggregated and distributed risk so that investors in mortgage securities were insulated from the failure of any one or several mortgages.

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[14] Jacob Hacker, *The Great Risk Shift: The Assault on American Jobs, Families, Health Care and Retirement and How You Can Fight Back* (New York: Oxford University Press, 2006).

Most importantly, government backing of the mortgage securities market was essential in establishing investor confidence. Wall Street investors took advantage of their reduced exposure to risk, pouring money into mortgages in high poverty and working-class areas that were previously the domain of local predatory lenders.[15] Securitization thus opened the door to federally backed subprime lending. Lower-class homebuyers found it easier to obtain a mortgage but these mortgages carried high and often adjustable interest rates, and by making possible smaller down payments, these mortgages led to increased levels of homeowner debt. The Crash of 2008 highlighted—to a devastating degree—the "great risk shift" that had occurred within the home finance system over the previous forty years.

Mortgage securitization was largely a product of growth liberals' turn to finance starting in the late 1960s. Securitization offered a solution to the inability of the New Deal Home Finance System to maintain mortgage access during a time of inflation. Throughout the period, securitization enjoyed widespread bipartisan support, but growth liberals were the most important architects of the Securitized System. The promise of widespread homeownership that securitization seemed to offer fit well with growth liberalism's belief that social reforms could be achieved without sacrificing domestic economic growth or global American supremacy.[16] Growth liberals, such as President Johnson, accepted that the nation was entering a period of high inflation and interest rates in the late 1960s. They refused to directly confront the Federal Reserve over rising interest rates and reinforce the New Deal System's regulatory regime, as economic populists such as Wright Patman and Albert Gore, Sr. suggested. But they were nonetheless committed to the New Deal's mandate for government-supported, mass

[15] On predatory lending in the New Deal System see, for example, Beryl Satter, *Family Properties: Race, Real Estate and the Exploitation of Black Urban America* (New York: Metropolitan Books, 2009).
[16] On "growth liberalism," see Robert Collins, "Growth Liberalism in the Sixties: Great Societies at Home and Grand Designs Abroad," in *The Sixties: From Memory to History*, David Farber, ed. (Chapel Hill: University of North Carolina Press, 1994), 11-44.

homeownership. Thus, they campaigned for the continuing importance of a government apparatus to regulate and subsidize the home finance industry. Because of inflation, however, growth liberals needed to find new methods of supporting the housing market. Government-subsidized mortgage securitization offered a way to carry forward the New Deal's promise of mass homeownership in a new, more turbulent economic era.

Liberals were also key to shaping the Securitized System as it developed in the 1970s and 1980s. In the late 1970s, progressive Democrats such as Senator William Proxmire and Housing and Urban Development Secretary Patricia Harris criticized Fannie Mae and Freddie Mac for disinvesting from urban and lower-income communities. They pressured the GSEs to revise their mortgage purchasing policies, but their campaign was cut short by an inflationary crisis at the end of the decade. Yet again, rising inflation and interest rates jeopardized the home finance system. During the early 1980s, liberal policymakers put aside questions of equity in the mortgage market in order to focus on preserving widespread access to homeownership. They successfully defeated an attempt by the Reagan Administration to end the GSEs' government support. Instead, the Secondary Mortgage Market Enhancement Act (SMMEA) of 1984 increased government aid for the GSEs. With the thrift industry in crisis, SMMEA guaranteed that government-subsidized securitization would replace the New Deal's reliance on local thrifts. Once again, in the face of inflation, the goal of mass homeownership was the overriding concern of liberal policymakers.

In focusing on the key role played by growth liberals in shaping the home finance system from the 1960s though the 1980s, "The Ownership Society" challenges the notion that the rise of the New Right and the election of Ronald Reagan defined the politics of the era.[17] As Daniel Rodgers writes, "the decisive realignment election that political observers anticipated all through the period… failed to take place. Divided, not unitary, government was the rule in the last quarter of the century."[18] Democrats continued to hold significant power both in terms of electoral offices and political discourse. Just as the era saw the flowering of a new conservatism, it also witnessed significant changes in the contours of American liberalism. As Matthew Lassiter argues, Democrats and Republicans both embraced a middle-class, suburban-oriented politics "expressed through the color-blind language of consumer rights and meritocratic individualism."[19] Rather than abandoning economic issues for environmentalism, foreign policy, or identity-based politics centered around race and gender, as some have argued, Democrats adjusted their stance on economic issues.[20] As Lily Geismer contends, "liberalism and the Democratic Party increasingly came to reflect the materialist concerns of suburban knowledge workers rather than autoworkers."[21] Central to these materialist concerns was the maintenance of government support for the mortgage market and suburban homeownership. But Democrats were not only sensitive to highly educated, affluent suburban homeowners. They also believed that the same suburban-oriented politics could be applied to the working class and racial minorities.

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[17] For scholarship that emphasizes the rise of the New Right and the 1980 election see, for example, Matthew Dallek, *The Right Moment: Ronald Reagan's First Victory and the Decisive Turning Point in American Politics* (New York: Free Press, 2000); Donald T. Critchlow, *The Conservative Ascendancy: How the GOP Right Made Political History* (Cambridge: Harvard University Press, 2007); Steve Fraser and Gary Gerstle, eds., *The Rise and Fall of the New Deal Order, 1930–1980* (Princeton: Princeton University Press, 1989); and Lisa McGirr, *Suburban Warriors: The Origins of the New American Right* (Princeton: Princeton University Press, 2001).

[18] Daniel Rodgers, *Age of Fracture*, 3.

[19] Matthew Lassiter, *The Silent Majority: Suburban Politics in the Sun Belt South* (Princeton: Princeton University Press, 2006), 3.

[20] Historians who have argued that Democrats increasingly embraced "post-economic issues" during the 1970s and 1980s include Judith Stein and Jefferson Cowie. Judith Stein, *Pivotal Decade;* Jefferson Cowie, *Stayin' Alive: The 1970s and the Last Days of the Working Class* (New York: New Press, 2010).

[21] Lily Geismer, *Don't Blame Us: Suburban Liberals and the Transformation of the Democratic Party* (Princeton: Princeton University Press, 2015), 1.

Their conviction that securitized homeownership would prove to be a panacea for class and racial inequality would prove to have significant costs.

The New Deal Home Finance System

In the 1930s, the New Deal revolutionized home finance.[22] It created the basic concept of a fully amortized, government-backed mortgage, making mortgaged homeownership accessible to millions of Americans. New Dealers created a set of new policies and government agencies dedicated to supporting home finance institutions. Most important among these were the Federal Housing Administration (FHA), which insured financial institutions against losses in the mortgage market, and the Federal Home Loan Bank system (FHLB), which provided government-subsidized credit for mortgage investment. These agencies channeled federal support for homeownership through thousands of banks and especially thrift institutions, which included Mutual Savings Banks, Credit Unions and most importantly Savings and Loan Associations (S&Ls).

The architects of the New Deal System were wary of the financial speculation that had sparked the Great Depression. By subsidizing a system of small, specialized financial institutions, they believed they could achieve their homeownership goals without repeating the mistakes of the 1920s. A host of federal and state regulations limited these institutions in terms of the types of business they could do. Most famously, the Glass-Steagall Act of 1933 separated investment banking from commercial banking, creating a clear divide between middle-class financial consumers of commercial banks and Wall Street investment banks. Meanwhile,

[22] See, for example, Kenneth Jackson, *Crabgrass Frontier: The Suburbanization of the United States* (New York: Oxford University Press, 1985); and David Freund, *Colored Property*.

regulations strictly limited S&Ls to the business of mortgage lending and savings accounts. Regulations also enforced limits on the geographic areas within which financial institutions could do business. For the most part, banks could not operate across state lines and many states significantly limited their ability to operate more than one office. Regulations were stricter for S&Ls, which had the largest share of the home lending market. They could only finance mortgages within fifty miles of their home office (which was most often their only office). S&Ls often used urban savings to finance suburban mortgages within the same metropolitan area but they could not finance mortgages in other cities. Meanwhile, S&Ls drew their capital mostly from their local areas. For example, in 1960 the typical California S&L drew more than three-quarters of its capital from within twenty-five miles of its home office.[23]

The New Deal System, though revolutionary, did not entirely remake the financial industry. Instead, it integrated elements of the already existing financial system. Above all, it championed the independent S&L, which had a long history in the United States. S&Ls, or Building and Loans (B&Ls), as they were earlier called, had roots going back to seventeenth-century England.[24] Originally conceived as self-help societies for the growing urban middle-class, these institutions were most usually owned by their account-holders. Their plan was simple: by aggregating the savings of its members, an S&L could finance mortgages for its community. S&Ls were conservative by design. Leaders of the S&L industry saw themselves as protectors of their community's financial security. In 1962, the United States Savings and Loan League commissioned a study of its industry by Northwestern University business professor Leon T. Kendall, who remarked that, unlike commercial banks, "widespread, economical home

[23] C. Jospeh Clawson, Frank W. Barsalou, et. al, *The Savings and Loan Industry in California* (South Pasadena, CA: Southern California Laboratories of Stanford Research Institute, prepared for California Dept. of Savings and Loan, 1960), Bancroft Library, II-8.
[24] David Mason, *From Building and Loans to Bail-Outs*.

ownership is the primary raison d'etre of the [S&L] business." If S&Ls lost this specialized mission "and the general investment market were made its province, there probably would not be so great and economic and social justification for the existence of these associations."[25]

Through the FHLB, the New Deal System gave the S&L industry unprecedented prominence. S&Ls made for good protagonists. Their roots in a bourgeois ethos of self-help, their aversion to risk and their avowed communitarianism made them an antidote to the reckless Wall Street speculation of the 1920s. At the same time, they were private businesses, not government agencies. Their executives were local business leaders and promoters of entrepreneurship. As David Freund has argued, S&Ls provided the New Dealer with a mechanism to enact a revolutionary program of social welfare without challenging the fundamentals of the American "free enterprise system" or inviting political opposition from business.[26]

Though connected to national circuits of capital through federal institutions such as the FHLBB, the institutions of the New Deal System were largely locally capitalized, reliant on the savings accounts of their home communities to issue and retain ownership of mortgages within a legally circumscribed region. For the financial elites that controlled these institutions, mortgages created a set of economic and political imperatives grounded in the financial viability of local real estate markets and the specificities of place. Financial executives were thus invested in the color lines that structured the postwar housing market.

[25] Leon T. Kendall, *The Savings and Loan Business: Its Purpose, Functions, and Economic Justification* (Englewood Cliffs, N.J.: Prentice-Hall, 1962), 1-2.
[26] On the importance of constructing a home finance system that was ostensibly in accord with the "free market system" see David Freund, *Colored Property*.

The New Deal System ameliorated the housing crisis of the 1930s and, after the end of the Second World War, financed the nation's housing boom. It also helped to build the highly segregated suburbs of the postwar era. New Deal policy and S&L business practices heavily favored suburban development at the expense of urban areas. They largely denied mortgages to unmarried women, African Americans and other racial minorities, and even white male-headed households living in racially mixed communities. Patriarchy and Jim Crow, in the North, the South and the West, thrived under the New Deal System.

The Securitized Home Finance System

Unlike the birth of the New Deal System, the Securitized System came to dominance gradually—over two decades, the 1970s and 1980s—and without much notice of its significance. The former system's origins were in depression and war, providing a clear demarcation between it and what came before. Securitization, on the other hand, existed alongside and within the New Deal System through the 1970s and the early 1980s. Indeed, it took years for securitization to coalesce into a distinct system of home finance. Yet, the architects of the Securitized System transformed home finance in ways far beyond what New Dealers could conceive and the results were just as far-reaching as the earlier revolution in home finance.[27]

Securitization transformed concrete, illiquid mortgages into abstract, liquid securities that represented investments in neither specific homes nor local real estate markets but rather massive pools of mortgages from across the country.[28] It consolidated local circuits of capital previously dominated by place-bound financial institutions into national and international circuits

[27] For an introduction to securitization see Leon T. Kendall and Michael J. Fishman, ed., *A Primer on Securitization* (Cambridge: MIT Press, 1996).
[28] Saskia Sassen, "When Local Housing Becomes an Electronic Instrument: The Global Circulation of Mortgages — A Research Note," *International Journal of Urban and Regional Research* 33:2 (June 2009), 411-426.

dominated by a few large institutions operating across regional and national boundaries. And it abstracted the value of real estate from its material existence in a way similar to the impact of commodity markets on the value of goods like grain and oil. As Freddie Mac President Leland C. Brendsel declared in 1996, "Securitization enables the individual home buyer to compete for credit in worldwide capital markets."[29]

While the New Deal System relied on the FHA and FHLBB to construct a new mortgage market, the Securitized System relied on Ginnie Mae, Fannie Mae, and Freddie Mac. Fannie Mae had its roots in the New Deal but remained a relatively small part of the mortgage market before the 1970s. Its mandate was to provide countercyclical relief to the mortgage market by purchasing mortgages from financial institutions when the market was tight and selling them when the market was loose. But, its mortgage transactions never amounted to a large portion of the mortgage market. The vast majority of mortgages remained in the hands of local financial institutions.

The 1968 Housing Act separated Fannie Mae into two corporations. Its low-income special assistance programs became Ginnie Mae, while the remaining operations became a privately owned, profit-seeking corporation—the new Fannie Mae. The new Fannie Mae was unlike other private financial institutions due to its enjoyment of special government support. It was exempt from many tax obligations and regulations, including capital-to-liability ratios. It also maintained a line of credit with the Treasury. Most importantly, its financial viability was guaranteed by the federal government. This guarantee was not made explicit in the 1968 Housing Act, but investors understood that the government would never allow Fannie Mae to collapse. As

[29] Leland Brendsel, "Securitization's Role in Housing Finance: The Special Contributions of the Government-Sponsored Enterprises," in Leon T. Kendall and Michael J. Fishman, eds., *A Primer on Securitization* (Cambridge, Mass.: MIT Press, 1996), 19.

the Johnson Administration intended, these benefits enabled Fannie Mae to purchase mortgages on an unprecedented level. In 1970, Congress created Freddie Mac, which was structured in a similar fashion as Fannie Mae, but charged solely with purchasing mortgages solely from thrift institutions. Fannie and Freddie were neither wholly private nor wholly public. As such, they became known under the ambiguous term of "government-sponsored enterprises" (GSEs).[30] As former general counsel of Fannie Mae David Stanton describes, the GSEs "raise money the way the federal government does but lend that money as a private institution."[31] In essence, the unique status of the GSEs privatized profits while socializing risk.

The 1968 Housing Act also created a new financial instrument, the mortgage-backed security. The GSEs were given the ability not just to purchase mortgages but also to transform them into securities. With their new purchasing power, they could buy thousands of mortgages, assemble them into pools and sell shares of these pools to a wide variety of investors. Securitization provided the mortgage market with huge new sums of capital. Under the New Deal System, bank and thrift deposits financed most mortgages. Under the Securitized System, mortgage debt outpaced deposits. By 2009, the nation's total outstanding mortgage debt was $14.2 trillion, nearly twice that of the $7.5 trillion in total bank deposits .[32]

The transformative policies of the 1968 Housing Act reflected the centrality of homeownership to American politics.[33] Homeownership supposedly made good citizens,

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[30] For a short history of GSE status see Lloyd D. Musolf, *Uncle Sam's Private Profitseeking Corporations: Comsat, Fannie Mae, Amtrak, and Conrail* (Lexington, Mass.: Lexington Books, 1982). Other books covering the costs and benefits of GSE status from a "free-market" libertarian viewpoint is Thomas H. Stanton, *A State of Risk: Will Government-Sponsored Enterprises Be the Next Financial Crisis?* (New York: HarperBusiness, 1991) and Thomas H. Stanton, *Government-Sponsored Enterprises: Mercantilist Companies in the Modern World* (Washington, D.C.: AEI Press, 2002).

[31]Thomas Stanton, *A State of Risk*, 39.

[33] On the importance of homeownership see for example Gwendolyn Wright, *Building the Dream: A Social History of Housing in America* (New York: Random House, 1981); Lizabeth Cohen, *A Consumers' Republic: The Politics of Mass Consumption in Postwar America* (New York: Knopf, 2003).

granting both freedom and civic responsibility.[34] It supported the formation of male-breadwinner households and promoted the American Dream of independence and affluence. Similar ideas about homeownership had shaped the construction of New Deal housing policies. And in the postwar era, politicians and financial executives imbued homeownership with the power to aid the U.S.'s struggle against communism and guarantee U.S. economic and moral leadership throughout the world.[35] In the 1960s, Johnson and other politicians argued that homeownership could help solve the "crisis of the cities." These powerful discourses about the value of homeownership aided the president in securing passage of the 1968 Housing Act with little Congressional opposition.

The securitized system increased both the availability and the risk of mortgages.[36] Mortgages became riskier on an individual and systematic level. The new system infused the mortgage market with vast sums of capital to invest in mortgages. Special government programs and new financial techniques directed a significant portion of this capital towards lower-middle-class mortgages. This infusion of capital made mortgages more accessible to groups that had been denied access to mortgaged homeownership under the New Deal system. Working- and middle-class whites, African Americans and Latinos took advantage of this new opportunity, increasing homeownership rates among these groups and fueling their suburbanization from the

[34] See for example Jackson, *Crabgrass Frontier*; Freund, *Colored Property*; Lizabeth Cohen, *A Consumer's Republic*.
[35] See for example Elaine Tyler May, *Homeward Bound: American Families in the Cold War Era* (New York: Basic Books, 1988).
[36] For increased risk of mortgages, particularly in the subprime market see, for example, Elvin Wyly and C. S. Ponder, "Gender, Age, and Race in Subprime America," *Housing Policy Debate* 21:44 (2011), 529-64; Kathleen C. Engel and Patricia A. McCoy, *The Subprime Virus* (New York: Oxford University Press, 2011); Daniel Immergluck, *Foreclosed* (Ithaca, N.Y.: Cornell University Press, 2009); Manuel B. Aalbers, ed., *Subprime Cities: The Political Economy of Mortgage Markets* (West Sussex, U.K.: Wiley-Blackwell, 2012); and Gregory D. Squires, ed., *From Redlining to Reinvestment* (Philadelphia: Temple University Press, 1992).

1970s onwards.[37] Yet, at the same moment that the new system granted increased (though far from equitable) access to mortgages, it also transformed mortgaged homeownership into a much riskier prospect for homeowners, especially black and Latino homeowners. Subprime mortgages were only the most extreme example. Speculative homebuilding, variable interest rates and easier credit diminished the financial security of mortgaged homeownership for all but the wealthiest homeowners.

Meanwhile, the securitized system drastically reduced risk for mortgagees—the financial institutions that owned mortgages—and investors in mortgage securities.[38] By aggregating large numbers of mortgages, the GSEs and Wall Street were able to decrease their exposure to risk on any individual mortgage. They also developed complex financial instruments that distributed risk so that investors could chose a particular security that fit their own preferences. Investors in MBS could play it safe or gamble as they wished, or, more likely, build a diversified portfolio that incorporated both high- and low-risk securities. The development of these new financial techniques coincided with a growing campaign to provide mortgaged homeownership to the nation's lower classes and racial minorities, which had its roots in liberalism's response to the Civil Rights Movement. It gave birth to special FHA programs that financed lower-class mortgages, and later, to minority homeownership initiatives under the Clinton and George W. Bush administrations. Financial institutions took advantage of these programs, using the vast new pools of capital and the new risk-abating instruments of the securitized system to pour money into lower-class mortgages. Most importantly, massive government support reduced

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[37] See, for example, Andrew Wiese, *Places of Their Own: African American Suburbanization in the Twentieth Century* (Chicago: University of Chicago Press, 2004); and Robert Lake, *The New Suburbanites: Race and Housing in the Suburbs* (New Brunswick: Center for Urban Policy Research, 1981).

financial institutions' exposure to risk. During a time when "free market" economics supposedly reigned supreme, the state only became more important to the home finance market. Even though the GSEs were technically not backed by government insurance, investors understood that Washington would never allow their mortgage obligations to go unfulfilled.

The securitized system consolidated both state and business power in the hands of a few. Indeed, it involved an entirely different scale of power than the New Deal System. Take, for instance, the gulf between a typical Chicago S&L in the 1960s, which perhaps held one or two hundred million dollars in assets, and the trillions of dollars in assets currently held by the GSEs and Wall Street firms that dominate the securitized home finance system. In 1984, there were over fifteen thousand separate banks and thrifts in the United States. By 2003, there were less than eight thousand, even as total bank assets increased by seventy percent.[39] According to the FDIC, "nearly all the decline [in the number of separate banks and thrifts] came in the community bank sector."[40] The power differential between mortgagor and mortgagee, between homeowner and financial executive, grew drastically.

Much of what has been termed "deregulation," rather than decreasing state power has, in fact, merely consolidated state power.[41] The evolution of regulatory power upwards meant that government involvement in home finance was hidden behind multiple layers of bureaucracy and

[39] Kenneth D. Jones and Tim Critchfield, "Consolidation in the US Banking Industry: Is the 'Long, Strange Trip' About to End?" *FDIC Banking Review* 17:4 (2005), 33.
[40] Ibid.
[41] On "deregulation" see, for example, Matthew Sherman, "A Short History of Financial Deregulation in the United States," (Washington: Center for Economic and Policy Research, 2009). http://www.cepr.net/documents/publications/dereg-timeline-2009-07.pdf; Eugene N. White, "Banking and Finance in the Twentieth Century," in *The Cambridge Economic History of the United States: The Twentieth Century*, eds. Stanley L. Engerman and Robert E. Gallman (Cambridge, UK: Cambridge University Press, 2000), 743-802. Another example, specifically on mortgages, is Daniel Immergluck, *Foreclosed : High-Risk Lending, Deregulation, and the Undermining of America's Mortgage Market* (Ithaca: Cornell University Press, 2009). Even though Immergluck points to government action in the changing mortgage market he still couches his argument in "intervention" and "deregulation" discourse.

was less responsive to local concerns. (Contrast the public meetings of New Deal thrift regulators for approving the location of a new S&L with the closed-door meetings of the Federal Reserve, an institution that became increasingly important as the Securitized System grew and became more deeply intertwined with Wall Street). Financial institutions might have much more latitude in determining whether and where they can open or close a particular office but the decisions of elite government regulators have become even more crucial in shaping the home finance system.

"The Ownership Society" will contribute to a growing body of literature that highlights the continuity of state action in the US economy. On a fundamental level, as Manuel Aalbers argues, the entire mortgage process relies on the state creating and enforcing property rights.[42] This remained true throughout the era of so-called deregulation. As Judith Stein contends, the "deregulation" of the 1970s and 1980s was not the "unleashing" of the "free market" but rather the creation of a new set of rules advantageous to certain business interests.[43] One important example for my dissertation is the round of ostensible "deregulation" of the S&L industry in the early 1980s. Kitty Calavita, Henry N. Pontell, and Robert H. Tillman point out that policies sold by politicians as "deregulation" were actually new sets of rules that greatly benefitted banks and thrifts.[44]

"The Ownership Society" engages a growing body of historical literature that suggests more continuity in the history of welfare and the power of the state than rise-and-fall narratives centered on the New Deal.[45] In contrast to focusing on labor relations or well-known, New-Deal-

[42] Manuel B. Aalbers, "The Sociology and Geography of Mortgage Markets: Reflections on the Financial Crisis" *International Journal of Urban and Regional Research* 33:2 (2009), 281-290.
[43] Judith Stein, *Pivotal Decade.*
[44] Calavita, Pontell, and Tillman, *Big Money Crime : Fraud and Politics in the Savings and Loan Crisis*.
[45] For recent rise-and-fall narratives see, for example, Cohen, *A Consumer's Republic*; Jefferson Cowie and Nick Salvatore, "The Long Exception: Rethinking the Place of the New Deal in American History," *International Labor and Working-Class History* 74 (Fall 2008), 1-32.

Era public welfare programs like Social Security or Aid to Families with Dependent Children, scholars like William Novak, Christopher Howard, and Jacob Hacker turn our attention to the seemingly mundane policy arenas of state police power, taxes, and regulation—arenas whose banal discourse obscures tremendous power to profoundly shape the everyday lives of Americans.[46] These authors convincingly argue that the complex, local, highly specific, intangible and/or intricate nature of state power, with its technical rhetoric, has been elusive to scholars trained to look for New-Deal-Era-type policies. This helps to explain the dissonance between the state actions they describe, on the one hand, and the prevalence of free-market ideology and the rhetoric of individualism so popular in the US, on the other hand. The same can be said for mortgage policy. Few in the general public or in academia understand the complex financial arrangements involved in mortgage securitization. The effects of mortgage securitization are embedded in the landscape and thus experienced everyday by most Americans. Yet, they are also filtered through a series of institutional intermediaries that obscure the process of securitization.

GSE securitization is illustrative of the potential for mutual symbiosis between the state and the market and, even more profoundly, the inextricability of the state from the market in contemporary capitalism. Fernand Braudel and Giovanni Arrighi argued that the most important historical transformation in the development of European capitalism was not the shift from feudal to capitalist labor arrangements nor the growth of capitalist enterprise but rather the

[46] William J. Novak, *The People's Welfare : Law and Regulation in Nineteenth-Century America*, Studies in Legal History (Chapel Hill: University of North Carolina Press, 1996); Christopher Howard, *The Hidden Welfare State: Tax Expenditures and Social Policy in the United States*, Princeton Studies in American Politics (Princeton, N.J.: Princeton University Press, 1997); Jacob S. Hacker, *The Divided Welfare State : The Battle over Public and Private Social Benefits in the United States* (New York: Cambridge University Press, 2002).

"fusion of state and capital."[47] David Freund gives a twentieth century example of this fusion, arguing that the government "created" the postwar housing market, rather than merely intervening in it or subsidizing it. "The Ownership Society" carries Freund's story forward to the late twentieth century, showing how the government created a new type of mortgage market. It endorses Freund's argument that policymakers and mortgage bankers obscured state action and successfully promoted the idea that "urban and suburban outcomes resulted solely from impersonal market forces," thus providing fertile ground for the development of a suburban political stance that emphasized individual, consumer rights in a supposedly meritocratic free market.[48]

Securitization increased capital mobility within the home finance system similar to the way capital mobility in the manufacturing sector has produced new patterns of industrialization and deindustrialization.[49] Wall Street sought out mortgage investment wherever it was most lucrative. While the New Deal System incorporated geographic regulations to inhibit capital mobility, the Securitized System encouraged it. Wall Street prospered on speculation. The Securitized System therefore stimulated speculative homebuilding—sprawling tracts of ever larger, planned communities of cheaply constructed but well-marketed and often monumental homes. The subdivisions that securitization financed were communities where the promise of extreme suburban affluence always seemed to outstretch the reality of shrinking municipal services, overly optimistic development plans, empty lots, and unfinished homes—even during good times. When the bubble burst, as it did in the mid-1980s and late 2000s, speculative

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[47] Fernand Braudel, *Afterthoughts on Material Civilization and Capitalism* (Baltimore, MD: Johns Hopkins University Press, 1977); quote from Giovanni Arrighi, *The Long Twentieth Century: Money, Power, and the Origins of Our Times* (London: Verso, 1994), 11.
[48] David Freund, *Colored Property,* 9.
[49] Barry Bluestone and Bennett Harrison, *The Deindustrialization of America: Plant Closings, Community Abandonment, and the Dismantling of Basic Industry* (New York: Basic Books, 1982); Jefferson R. Cowie and Joseph Heathcott, *Beyond the Ruins: The Meanings of Deindustrialization* (Ithaca: ILR Press, 2003); and Jefferson Cowie, *Capital Moves: RCA's Seventy-Year Quest for Cheap Labor* (Ithaca, N.Y.: Cornell University Press, 1999).

homebuilding left a trail of foreclosure, defunct homeowner associations and ultimately suburban blight—something nearly inconceivable under the New Deal System. As Sharon Zukin writes, drawing off of Karl Polanyi, "abstract market forces that detach people from social institutions have overpowered specific forces of attachment with place."[50] As Zukin this is as a broader transformation than simply the movement of industrial jobs: "capital moves, the community doesn't."[51] In the contemporary metropolitan landscape, homeownership, Zukin writes, "is surrounded by a contradictory aura of both autonomy and dependence…[It] may emphasize either stability or lack of mobility. In this sense, it represents a cultural compromise between market and place."[52]

The Securitized System, like the New Deal System, benefitted large-scale suburban development on the metropolitan periphery. But even more than the New Deal System, it favored larger, planned developments because the GSEs could most efficiently securitize when buying in bulk. Securitization also fueled speculation in high-growth areas, leading to home-building booms in places like Southern California and Houston. "The Ownership Society" adds to a literature on these far-flung suburbs. Robert Fishman coined the term "technoburbs" to describe a series of suburbs that are no longer dependent on an urban core, especially in terms of employment.[53] Rob Kling, Mark Poster, and Spencer Olin coined the term "postsuburban" to describe the multi-centered development of Orange County California.[54] Joel Garreau describes the business districts of these sprawling areas as being "edge cities," with dense concentrations

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[50] Sharon Zukin, *Landscapes of Power : From Detroit to Disney World* (Berkeley: University of California Press, 1991), 4.
[51] Sharon Zukin, *Landscapes of Power*, 15
[52] Ibid., 11.
[53] Robert Fishman, *Bourgeois Utopias: The Rise and Fall of Suburbia* (New York: Basic Books, 1987).
[54] Rob Kling, Spencer C. Olin, and Mark Poster, *Postsuburban California: The Transformation of Orange County since World War II* (Berkeley: University of California Press, 1991).

of employment and retail.[55] Robert Lang sees the focus on "edge cities" as diverting attention from the much larger growth of "edgeless cities," where retail and office space is dispersed through a sprawling landscape, whose form is "illimitable, indefinite, undiscovered, imperceptible, elusive."[56]

Meanwhile, in the city, the Securitized System promoted both gentrification and urban disinvestment. Just as it did in the suburbs, securitization intensified housing speculation in select city neighborhoods. At the same time, the new system decimated non-gentrifying urban communities. Low-income homeownership initiatives, funded by securitization, federalized blockbusting and the exploitation of minority homeowners.[57] Government backing of mortgages under these programs provided fraudulent and abusive lenders with insurance when these loans went bad. And securitization dispersed ownership of these mortgages, meaning that local financial institutions had less of a vested interest in the long-term economic well being of any particular community. Local financial agents would have little to lose if home values plummeted after a wave of blockbusting, declining home values and ultimately foreclosure.

Meanwhile, home finance networks became less transparent as a result of several factors. Increasing complexity of the financial instruments involved made it more difficult for non-experts to understand the way that the securitized system transferred capital. Financial institutions have become not only larger; their structure has also become more hierarchical and specialized. The bank tellers, loan officers and managers at the local branch office are distant (both physically and metaphorically) from the decision-making executives and the Wall Street

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[55] Joel Garreau, *Edge City: Life on the New Frontier* (New York: Doubleday, 1991).
[56] Robert Lang, *Edgeless Cities: Exploring the Elusive Metropolis*, Brookings Metro Series (Washington, D.C.: Brookings Institution Press, 2003). 2.
[57] Andrew Highsmith, "Prelude to the Subprime Crash," *Journal of Policy History* 24:4 (2012), 572-611; Keven Fox Gotham, "Separate and Unequal: The Housing Act of 1968 and the Section 235 Program," *Sociological Forum* 15:1 (2000), 13-37.

traders who shape the institutions' market strategy. This is in stark contrast to the New Deal system where tellers and thrift presidents often worked in the same office. As the home finance system's networks of power became more unequal and less visible, securitization devastated the capacity for any individual homeowner or group of homeowners to effect political change within the home finance system. This is especially true for grassroots movements that have sought a more transparent, equitable and stable home finance system.

On a microlevel, the Securitized System softened patterns of segregation. But, on a macrolevel, it hardened them. The Securitized System relished the opportunity to capitalize on discrimination and segregation. These were, after all, effective ways to achieve market segmentation and Wall Street thrived on dividing and categorizing commodities. During the early postwar era, financial institutions relied on federally supported Jim Crow color lines to segregate and discriminate.[58] Even after the 1968 Fair Housing Act outlawed racial discrimination in the mortgage market, ineffectual enforcement meant that discrimination continued.[59] Moreover, financial executives working for the GSEs and Wall Street developed more complex modes of segregation and discrimination. As Elvin Wyly C. S. Ponder, Pierson Nettling, Bosco Ho, Sophie Ellen Fung, Zachary Liebowitz, and Dan Hammel argue, "inequalities once understood as local, neighborhood-level processes have been interwoven with

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[58] See, for example, David Freund, *Colored Property*; Thomas Sugrue, *The Origins of the Urban Crisis: Race and Inequality in Postwar Detroit* (Princeton: Princeton University Press, 1996); Ira Katznelson, *When Affirmative Was White: An Untold History of Racial Inequality in Twentieth Century America* (New York: Norton, 2006); and Kevin Kruse, *White Flight: Atlanta and the Making of Modern Conservatism* (Princeton: Princeton University Press, 2006).

[59] Christopher Bonastia, *Knocking on the Door: The Federal Government's Attempt to Desegregate the Suburbs* (Princeton: Princeton University Press, 2006); Charles Lamb, *Housing Segregation in Suburban America Since 1960: Presidential and Judicial Politics* (New York: Cambridge University Press, 2005); and Douglas S. Massey and Nancy A. Denton, *American Apartheid: Segregation and the Making of the Underclass* (Cambridge: Harvard University Press, 1993).

national and transnational investment circuits."[60] These larger capital circuits, they contend, have replaced local, exclusionary forms of discrimination with more "flexible, *inclusionary* discrimination that promised opportunity and access to the wonders of the market." Wall Street traders, unlike local S&L presidents, were not concerned with the rare incursion of black families into white neighborhoods. They were more interested in general trends of market segmentation. The assumption that a given community was predominantly white and upper-income was more important than the messiness of tracking the race of every homeowner. As one Houston developer told a Congressional hearing in 1978, "everybody has heard that Houston is developed west, so if you come in with a project on the [predominately white] west side you are going to get the money; if you come in on the [racially diverse] east side, you are not going to."[61] Even financial executives in New York who were investing in Houston mortgages knew the bifurcated racial geography of Houston, he said. Because of this, the decision-makers in the Securitized System did not need to make their racial and class preferences explicit and absolute. They could use statistical proxies, rather than color-coded maps, to determine the class and racial demography of a particular community. As a result, bankers and brokers were scarcely self-aware of this development. The Securitized system integrated race and class bias into the structure of the housing market in a way that relied less on individual agency than the New Deal System required. Color lines became slightly more porous, and as such, they did not need the same level of policing by local financial executives. The more flexible, less explicit and more

[60] Elvin Wyly, C. S. Ponder, Pierson Nettling, Bosco Ho, Sophie Ellen Fung, Zachary Liebowitz, and Dan Hammel, "New Racial Meanings of Housing in America," *American Quarterly* 64:3 (Sep. 2012), 571-572.
[61] *Homeownership Task Force: Hearings Before the Subcommittee on Housing and Community Development of the Committee on Banking, Finance and Urban Affairs, House of Representatives,* 95th Cong. 631 (Jan. 24, 1978) (Statement of Tyler Todd).

porous color lines of the Securitized System made discrimination more difficult to prove and also blame more difficult to assign.[62]

Both the New Deal System and the Securitized System benefited financial institutions more than homeowners of any gender, race or class. Throughout the postwar era, policy directed mortgage subsides to financial institutions with the idea that they would trickle down to homeowners. The absence of financial institutions from much of the urban history literature has meant that historians have not fully recognized the extent of government subsidization of the financial industry. Historians of postwar suburbanization have rightly highlighted the ways that government policy benefited white, male-headed, middle-class households while denying access for racial minorities, women and the poor. They have overturned the simple narrative of "white flight" from the city, instead emphasizing how government policy drew whites to the suburbs.[63] "The Ownership Society" builds on this literature by directing attention to the finance industry.

"The Ownership Society" also highlights the continuity of business welfare from Roosevelt to Reagan. It builds on a historical literature that has emphasized business' comfortable relationship with postwar liberalism.[64] But it also shows how government policies since the 1970s have favored different kinds of business. Both liberals and conservatives became increasingly allied with larger corporate interests, undermining the New Deal's reliance on local

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[62] For difficulty in measuring secondary market effect on racial discrimination see Robert Van Order, "Discrimination and the Secondary Market," in John Goering and Ron Wienk, eds., *Mortgage Lending, Racial Discrimination, and Federal Policy* (Washington: The Urban Institute Press, 1996); and Robert Bullard and Donald Tryman, "Competition for Decent Housing," *Journal of Ethnic Studies* 7:4 (Winter 1980), 51.
[63] For example, Kenneth T. Jackson, *Crabgrass Frontier*; David Freund, *Colored Property*; and Lizabeth Cohen, *A Consumer's Republic*.
[64] For example, Wendy Wall, *Inventing the 'American Way': The Politics of Consensus From the New Deal to the Civil Rights Movement* (New York: Oxford University Press, 2008), Robert Collins, *The Business Response to Keynes, 1929-1964* (New York: Columbia University Press, 1981), Kim McQuaid, *Big Business and Presidential Power: From FDR to Reagan* (New York: Morrow, 1982), Robert Collins *More: The Politics of Growth In Postwar America* (New York: Oxford University Press, 2000).

business. Small, local S&Ls, for example, were a key constituency of the New Deal System. Even if their executives often voted Republican, the industry largely supported the New Deal's regulatory regime. In 1968, they opposed the Federal Reserve Board's decision to raise interest rates and instead supported a tax increase to fight inflation, and in 1980, they opposed interest rate deregulation.[65]

"The Ownership Society" is a history of a commodity: the home mortgage loan. Sidney Mintz's history of sugar and William Cronon's history of Chicago serve as inspiration.[66] The way securitization destabilized homeownership during the 1970s and 1980s was similar to the way that grain and sugar become commoditized in previous centuries. Mortgages became abstracted, liquid, exchangeable and untraceable. The role of the state is key in this process. Like other commodities, mortgages require standardization in order to transform infinitely variable material objects into abstract commodities. Thus, only institutions with authority across the many private participants in the market can effectively achieve universal standards. As Cronon and many other examples indicate, the government is usually involved in maintaining such standards.[67]

Yet, the commoditization of mortgages is different in key respects from commodities like sugar and grain. As Kevin Fox Gotham argues, real estate investment presents unique challenges for capitalism's inherent drive to overcome temporal and spatial boundaries in order to maximize profit.[68] Real estate investment covers long period of time, is diverse in its uses, and its value is dependent on local, specific factors. In other words, real estate is particularly difficult to abstract.

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[65] David Mason, *From Building and Loans to Bail-Outs*.

[66] William Cronon, *Nature's Metropolis: Chicago and the Great West* (New York: W.W. Norton, 1991); Sidney W. Mintz, *Sweetness and Power: The Place of Sugar in Modern History* (New York: Viking, 1985).

[67] William Cronon, *Nature's Metropolis*; Manuel Aalbers, ""The Sociology and Geography of Mortgage Markets: Reflections on the Financial Crisis"; and Kevin Fox Gotham, "Creating Liquidity out of Spatial Fixity: The Secondary Circuit of Capital and the Subprime Mortgage Crisis" *International Journal of Urban and Regional Research* 33:2 (2009), 355-371.

[68] Kevin Fox Gotham, "Creating Liquidity out of Spatial Fixity."

In a sense, a shaft of grain is also unique, but the differences mean less to humans' material life than in the case of place. The connection to place is a deeply personal and communal one. Thus, the institutional apparatuses necessary for turning real estate into a liquid commodity are even larger, more complex, and more vital than in the case of other commodities.

Methodology

The dissertation examines home finance at the local, metropolitan, state and federal levels.[69] In rejecting a predetermined scale of analysis, "The Ownership Society" illuminates the interaction between events occurring in various places and on differing levels of power. In doing so, it offers an expansive if not thorough view of home finance during this time. Hopefully, its diversity offers a compelling historical narrative, from the grassroots to the political and economic elite.

The dissertation also moves from place to place, from California to Chicago to Houston with periodic stops in Washington, DC. It combines a general outline of the home finance system as a whole with case studies that are illustrative of larger trends and/or instrumental in explaining how and why home finance has changed. The dissertation begins in California because the mortgage shortage of 1966 was especially severe in the state and because California policymakers had a disproportionate impact on federal policymaking in the years to follow. The next case study of Illinois and Chicago in particular highlights the financial localism of the New Deal System. Illinois was among the strictest states in terms of limiting industry consolidation and branching. Furthermore, Chicago was home to especially powerful grassroots homeowner

[69] It also refers to the importance of global events. Indeed, understanding global economic trends is vital to explaining home finance in the US. But the limits of my time and expertise have meant that the international perspective is mostly absent from my story. They occur in the background and I do not attempt to provide any significant analysis of events occurring outside of the U.S.

movements that challenged urban disinvestment and redlining in the 1970s. The final case study, Houston, is a prime example of how the Securitized System fostered both boom and bust. It highlights the dependence of Houston's housing market on federal subsidies, despite a Sun Belt political culture that narrated the city's growth as a product of the free market.

Such a project involves significant editorial discretion concerning where and when to focus the reader's attention. Like any work of history, these decisions are also constrained by the silences found in all historical archives. In this case, the silences are especially glaring given the secrecy of the financial industry and the lack of recordkeeping in the booming suburban exurbs of the Sun Belt (in contrast to say the civil rights and labor activists of northern cities, few Sun Belt suburbanites—or contemporary historians, for that matter—thought history was being made in their own communities). The result is a frustratingly incomplete work of history. Yet, the stories told here provide a diverse and unique narrative.

Chapter Outline

The dissertation has three parts, each with two chapters. "Part I: Origins" describes the birth of securitization in the late 1960s. Because of the New Deal System's limits on capital mobility, areas where mortgage demand was highest, such as California, suffered the most drastic capital shortages. Chapter 1 explores the California mortgage market of the 1960s and how the state's policymakers responded to the mortgage crisis of 1966. During the early postwar era, federal spending on housing, infrastructure, education and particularly the defense industry spurred economic growth in California, bringing people and capital to the state. Meanwhile, S&Ls—backed by the FHA and FHLB System—ensured the promise of homeownership. But in 1966, when interest rates rose, the ability of S&Ls to finance mortgages was devastated. The state's mortgage market virtually froze, and few homeowners could acquire a mortgage. In response, the administration of Governor Edmund Brown began to look beyond the S&L industry for new sources of home finance capital that could solve the state's mortgage shortage. In alliance with the state's financial industry, particularly a small group of mortgage bankers, the administration developed plans to market mortgages to a variety of investors, particularly pension funds. In order to make mortgages attractive to investors with little knowledge of the mortgage market or local real estate markets, the administration contemplated a form of mortgage securitization. By pooling mortgages together and selling shares in these pools, the risk of foreclosure and the cost of service would be spread across the market. Though these plans would be cut short by Ronald Reagan's victory in the November 1966 election, they would lay the groundwork for the transformative 1968 Housing Act.

Chapter 2 examines the federal response to mortgage shortages in the late-1960s. The Johnson Administration struggled to find a solution to the threat of inflation. One option was fiscal restraint—significant reductions in federal spending or tax increases. Yet, the Johnson Administration was unwilling to make meaningful sacrifices on either domestic spending or war spending, while tax increases faced stiff Congressional and popular opposition. Another option was monetary restraint—higher interest rates. A few populist Democrats in Congress, like Representative Wright Patman and Senator Albert Gore, Sr., argued for a different approach—strict capital and price controls, like those enacted during WWII. For the Johnson Administration, such proposals remained off the table. They worried that capital and price controls would endanger the dominance of the US dollar and weaken domestic economic growth. Growth liberals such as Johnson, had sold a vision of endless upward social mobility—and they had promised that the war in Vietnam would not change this vision. In the summer of 1967, President Johnson appointed Raymond Lapin, a former California mortgage banker and a "staunch Democrat," to be president of Fannie Mae. Lapin was one of Governor Brown's key advisors during the 1966 crisis and one of the strongest supporters of fundamental change in the home finance system. From the start of his tenure, Lapin marshaled his experience in California to lobby Congress and President Johnson for a reconfiguration of the mortgage market. The 1968 Housing Act fulfilled much of Lapin's vision. It gave birth to the mortgage-backed security and reorganized Fannie Mae into a privately-owned, for-profit, but government-supported corporation. The Johnson Administration explained the Act as a response to the "crisis of the cities," but its roots were in the policymakers' turn to finance.

"Part 1: Origins" is about the problem of inter-regional capital mobility within New Deal System. "Part 2: Localism" is about the problem of capital mobility on a local level. Chapter 3 explores home finance in Illinois during the late 1960s and early 1970s. While California was home to the nation's largest S&Ls, Illinois was home to the largest number of S&Ls. Illinois was one of the nation's most extreme examples of the New Deal System's commitment to localism. Strict regulations prohibited all financial institutions from operating more than one office. Throughout the 1950s and 1960s, Chicago's largest financial institutions sought to overturn branching restrictions but a majority of the state's financial institutions supported them. Geographic restrictions inhibited growth but also protected institutions from competition. Until the early 1970s, these smaller institutions, which controlled the major industry lobbies, were successful in preserving branching restrictions. Illinois S&Ls promoted themselves as locally rooted institutions with special responsibilities to their home communities, and their executives cultivated an image of themselves as enlightened patriarchs rather than savvy businessmen.

Stewardship of the community's economic resources, rather than profit, was their guiding mandate. When inflation and interest rates rose in the late 1960s, however, it jeopardized financial localism in Illinois. Across the nation, high interest rates hurt S&Ls, but small, urban S&Ls were especially troubled. The suburban favoritism of the New Deal System meant that urban mortgages were less lucrative than suburban mortgages, while geographic regulations inhibited urban institutions' ability to tap suburban markets. During the early postwar era, this limited the profitability of urban institutions but low interest rates and low inflation at least meant that such institutions could expect to remain financially stable. In the late 1960s, however, this expectation was no longer guaranteed. In 1971, the FHLB, fearful that urban S&Ls might fail, opened the door to financial branching in Illinois. Suburban branch offices would allow urban institutions to find new sources of revenue in booming suburbs. The FHLB's decision effectively ignited the suburbanization of Illinois' financial institutions.

Chapter 4 examines the political backlash against the suburbanization of home finance in Chicago during the early 1970s. Grassroots homeowner movements in the city's working class neighborhoods protested the deterioration of financial localism. They recycled the narratives of communal responsibility that the S&Ls had helped to create. This chapter builds a case study of one of these groups, the Citizens Action Program (CAP). In addition to branching, new federal programs for low-income, urban mortgages also fueled urban disinvestment. The 1968 Housing Act established the FHA Section 235 program. Under this program, HUD provided direct mortgage payment assistance for low-income mortgages. It was a financial bonanza for financial institutions. Not only would HUD supplement the mortgage payments of low-income homebuyers, Fannie Mae would immediately buy most of these mortgages from local lenders, relinquishing financial institutions from the risk of lending to homebuyers with little credit. With the government assuming all the risk, Section 235 became a vehicle for blockbusting working-class, urban neighborhoods. Lenders took advantage of mortgage demand among the black middle-class. With the benefit of government subsidy and without the long-term commitment of mortgage ownership, lenders did not have to worry about the dangers of delinquency and foreclosure. This freed them to originate mortgages on usurious terms to homebuyers that they knew could not make the mortgage payments. The deleterious effects of Section 235 on the economic well being of urban neighborhoods sparked CAP's initial foray into home finance politics. But the organization soon developed a more expansive critique of the changing mortgage market. They connected Section 235 to the liberalization of branching regulations and the growth of affluent suburbs on the metropolitan fringe. All of these trends thrived on the erosion of financial localism. CAP achieved significant successes. Their most powerful weapon was a direct action program of organized withdrawals from S&Ls targeted for especially egregious policies of urban disinvestment. But despite their efforts, the ground was shifting under their feet. Securitization and branching consolidated financial power. Organized withdrawals worked better for smaller financial institutions, where a few hundred thousand dollars made a significant difference in their day-to-day revenue stream. As large and distant financial institutions increasingly dominated the home finance system, CAP and other similar groups faced more powerful and less visible adversaries. CAP's organized withdrawals paled in comparison to the billions of dollars in mortgages held by Fannie Mae.

"Part 3: Securitization" is about the end of the New Deal System. Chapter 5 examines the changing politics of home finance in Washington from the late 1970s through the early 1980s. During the 1970s, mortgage securitization existed within a home finance system that was still dominated by New Deal institutions. Yet, the GSEs were already redirecting the flow of home finance capital. GSE policy favored new construction on the metropolitan fringe, especially prioritizing large-scale suburban subdivisions. It also redirected capital flows on an inter-regional basis. The vast majority of their mortgage purchases were in the growing suburbs of Southern and Western cities. They then sold these mortgages, or securities backed by these mortgages, to investors that were mostly located in the Midwest and Northeast. In essence, the GSEs used Rust Belt capital to finance Sun Belt growth. The Sun Belt favoritism of the GSEs worked together with other federal spending programs, such as defense and infrastructure investments, that also disproportionately benefitted the South and West. The array of federal programs that directed capital to the Sun Belt interacted with each other in a cascading manner, such that each federal program was both cause and consequence of other federal programs: federally subsidized employment begat federally subsidized housing and vice versa. That Houston and Los Angeles were among the prime beneficiaries of the secondary market's growth was no accident; it was a product of policy. Since the 1968 Housing Act, one of the primary goals of Fannie Mae, and later Freddie Mac, was to redirect mortgage money from "capital-rich" regions, mostly in the Northeast and Midwest, to "capital-poor" regions, mostly in the South and West. Fannie Mae and Freddie Mac provided a direct and secure method for northeastern and midwestern institutions to invest in southern and western mortgages.

Grassroots groups sought to bring the GSEs suburban and Sun Belt favoritism to light and for a moment, in the mid-1970s, their campaign caught the attention of federal policymakers. But at the end of the 1970s, the window of opportunity closed. Liberal policymakers, who were once sympathetic to the critiques of grassroots movements, were now consumed by a systemic mortgage crisis. Their attention shifted away from issues of financial equity. Instead, they focused on the ability of the middle class to access mortgages and other financial products. At the end of the 1970s, inflation reached heights unprecedented in the postwar era. In response, the Federal Reserve increased interest rates beyond the expectations of even the most hawkish predictions of the 1960s. Meanwhile, the Carter Administration was concerned with the effects of inflation on middle-class financial consumers. New Deal regulations placed a ceiling on the interest rates of savings accounts, barring middle-class savers from taking advantage of higher interest rates. At the same time, inflation eroded the real value of their savings. With Democratic Congressional support, the Carter Administration lifted interest rate ceilings in the name of helping the nation's "small savers."[70]

The S&L industry was opposed to the deregulation of interest rates. Their source of revenue—mortgage payments—were locked into the lower interest rates of previous decades. At the same time, without interest rate ceilings, they would have to offer higher returns to savers if they were going to compete with other investments, like CDs and mutual funds. Despite S&L opposition, the Carter Administration was successful in its efforts to deregulate interest rate ceilings. As a result, the S&L industry—a lynchpin of the New Deal System—was thrown into crisis. During the 1980s, the S&L industry withered away. Some survived the wave of failures but those that did abandoned the localism of the New Deal System and became virtually indistinguishable from banks. Most importantly, they were no longer the dominant source of home finance.

As the S&L system died, policymakers sought out a new way to finance the nation's mortgages. In the early 1980s, a consensus among politicians of both parties emerged.

[70] Robert B. Henderson, "Dream Deregulated: The Politics of U.S Housing Finance, 1968-1985," PhD diss., (History, University of Maryland, College Park, 2013).

Securitization would fill the hole left by the S&L crisis. For liberals, securitization would carry forward the promise of homeownership to a new generation. For conservatives, securitization would open the door to the growth of a private market in mortgages. The Secondary Mortgage Market Enhancement Act (SMMEA) of 1984 codified this consensus. It simultaneously bolstered the GSEs' position within the mortgage market and created new opportunities for private investment banks to capitalize on securitization.

Chapter 6 explores the changing home finance system in Houston from the late 1970s through the mid-1980s. Houston was a prime example of the Securitized System's Sun Belt and suburban favoritism. The GSEs purchased millions of dollars of Houston mortgages, intensifying a homebuilding boom sparked by the growth of the city's oil industry. They preferred new, large-scale developments on the metropolitan periphery. Planned communities encompassing hundreds, sometimes thousands, of acres offered GSEs the opportunity to buy relatively uniform mortgages in bulk.

Fannie and Freddie also helped to provide increased—though still limited—opportunities for black and Latino suburbanization. Yet, GSE policies—along with endemic racism in the real estate and home finance industries—created a highly segregated suburban landscape. The color lines were sometimes fuzzier and somewhat more permeable than during the early postwar era. Instead, suburban segregation followed broader patterns, with wide swaths of the metropolitan periphery (Houston's eastern suburbs, for example) becoming home to black and Latino suburbs while white suburbanization followed opposite vectors from the central city. Mortgage financing was less accessible and costlier in black and Latino suburbs, which were also usually located on less desirable tracts of land.

But just as Houston's boom during the 1970s revealed the extent to which the emerging securitized home finance system could generate a new landscape of large-scale subdivisions, the city's bust during the 1980s illustrated the immense level of risk that the new system involved. A precipitous drop in oil prices coincided with the turmoil in financial markets created by high interest rates. Developers, S&Ls and banks failed at record numbers. In both the city and the suburbs, foreclosures skyrocketed and Houston's homeowners were left wondering how to reconcile the promise of homeownership with the reality of economic ruin.

Unlike Chicago in the early 1970s, Houston's mortgage crisis did not spur grassroots homeowner movements. Its suburbs lacked the leftist political networks of working-class Chicago, and more importantly, potential movements were thwarted by the lack of visible local villains in the new Securitized System. In contrast to the local S&Ls of 1970s Chicago, the financial institutions of 1980s Houston were much larger, more powerful and obscured by the complexity of securitization. Many Houston homeowners were unaware that their mortgages had been sold on the secondary market. Thus, it was much more difficult to locate and protest financial decision-makers.

Part 1

Origins

Chapter 1

The California Origins of Mortgage Securitization

In July 1966, Governor Edmund "Pat" Brown of California urged Californians to join him in observing "Savings and Loan Month," in celebration of the industry's one hundred and one years of "enrich[ing] the lives of many Californians."[1] S&Ls were a vital part of the state's growth machine. California benefited from significant capital inflows during the era, primarily sparked by federal spending on infrastructure, education and the defense industries. S&Ls provided Californians with savings accounts and home mortgages. Financial institutions were key to Governor Brown's vision of an economically prosperous state of middle-class, suburban homeowners. It was therefore no surprise then that the governor marked off an entire month for commemoration of the industry's achievements. However, July 1966 was the *second* "Savings and Loan Month" declared by the governor in less than two years. Brown had also proclaimed January 1965 as "Savings and Loan Month" in commemoration of the industry's one hundred years of "help[ing] to build a stronger and more prosperous California through stimulation of thrift and home ownership."[2] The similarity in tone between the two proclamations belied a radical shift in the California home financing industry between January 1965 and July 1966.

[1] "Governor Brown Proclaims July as Savings and Loan Month," *California Savings and Loan Journal* 39:7 (Jul. 1966), 1.
[2] "Gov. Brown Opens Centennial S&L Observation," *Los Angeles Times* (Jan. 11, 1965).

Where the first Savings and Loan month was marked by optimism about the industry and the California economy in general, the second came amidst a severe downturn in the housing market. By mid-1966, rising interest rates on certificates of deposit (CDs) and corporate bonds and securities were drawing capital away from the S&L accounts that financed most mortgages in the state, making it nearly impossible for Californians to buy or sell a home. The crisis—in one of the state's most important industries—threatened to spread beyond the homebuilding and home financing sectors and undermine Brown's 1966 reelection campaign.

Brown's declaration of a second month dedicated to the S&L industry was only one part of a broader, aggressive program to address the crisis and garner political support from the state's home finance and homebuilding industries. Aiding the S&L industry—the dominant mortgage lenders in the state—was an important element of Brown's strategy. But merely bolstering existing networks of home finance would be woefully inadequate if California's growth machine was to continue at the breakneck speed of the early postwar years. Thus, Brown turned to the state's financial industry—especially mortgage bankers—to develop new ways of financing mortgages. Members of the Brown Administration and the financial industry envisioned an expansive partnership between the state and large, private financial companies. For the financial industry, the future of the mortgage market lay not in the New Deal home finance system of local S&Ls, but rather in the consolidation of the industry in the hands of a few large institutions: financial holdings companies, an expanded Federal National Mortgage Association (Fannie Mae), and institutional investors, particularly pension funds. These institutions, they imagined, would oversee a vast expansion of the secondary mortgage market. In order to facilitate this new market, state officials and bankers advanced new methods of trading mortgages. By pooling mortgages together and selling pieces of these pools to investors (a process later known as "securitization"), mortgage companies and Fannie Mae could attract investment from institutions without needing specialized knowledge of local mortgage markets.

Some of these ideas were not new. In the late 1950s and early 1960s, the home finance industry was already consolidating. Pension funds had begun to invest some money in mortgages, and mortgage banks had already begun to develop the first pooling techniques. Neither were many of these ideas actually achieved under Brown. Ronald Reagan's defeat of Brown in November 1966 ousted the coalition of growth liberals and bankers that envisioned a broad partnership between the finance industry and government in reorganizing the mortgage market. Meanwhile, changes in regulatory and fiscal policies at the federal level ameliorated the housing crisis for the time being.

Yet, the partnership between Brown and the finance industry in California in 1966 was an important moment in the trajectory of postwar liberalism. In turning to the financial industry for a way out of the economic conundrum caused by inflation, the Vietnam War, and the expectations created by postwar liberalism's promise of middle-class, home-owning affluence, the Brown Administration heralded the Democratic Party's increasingly close alliance with Wall Street and further drift away from the remnants of economic populism left by the New Deal. Though some of the techniques discussed by the Brown Administration were not novel, they had never before enjoyed such powerful support. Given the government's central role in the postwar mortgage market, these ideas could be achieved on a mass scale only through state power. And though the Brown Administration's vision was not achieved in 1966, it would have a lasting impact. The memory of the 1966 housing crisis would guide future debates regarding the government's role in the mortgage market. In the spring of 1967, President Lyndon B. Johnson appointed Raymond Lapin President of Fannie Mae. Lapin, a San Francisco mortgage banker, had been an important advisor to Brown during the crisis and one of the most influential voices calling for the reorganization of the home finance system. When another credit crisis struck in 1968, the new President of Fannie Mae lobbied Congress for approval of the association's reorganization as a privately owned, profit-seeking corporation and the authorization of mortgage securitization. The 1968 Housing Act provided the tools with which government officials and bankers would remake the U.S. housing market in the decades to come. The Brown administration's response to the 1966 mortgage crisis thus provides an origin story not only for mortgage securitization but also for the financialization of the American economy.

The California Mortgage Market

The S&L industry had specialized in providing savings accounts and mortgages to middle- and lower-class Americans since the mid-nineteenth century. They began as cooperatives, owned by their depositors, meant to encourage thrift and homeownership among the urban working class.[3] New Deal policy revolutionized the industry by providing massive government support to financial institutions that provided home mortgage. New Deal policy provided specific advantages for S&Ls. Through the Federal Home Loan (FHLB) system, S&Ls gained access to cheap federal credit. With federal support, S&Ls became the fastest-growing provider of mortgage capital in the nation. S&Ls were the financial institution of choice for fast-growing areas that lacked pre-existing networks of financial institutions large enough to meet the demand for housing that new migrants created. California contained many such areas, as federal spending on education, infrastructure and the defense industries brought capital and jobs to the state.

[3] David L. Mason, *From Buildings and Loans to Bail-Outs: A History of the American Savings and Loan Industry* (Cambridge: Cambridge University Press, 2004).

California was home to the nation's fastest-growing population, and Southern California was the fastest-growing region in the state. Southern California alone accounted for 12 percent of the nation's total residential construction in 1966.[4]

S&Ls were central to the tremendous growth of the state, particularly in the south. California was home to the largest S&L industry and the largest S&Ls. Most S&Ls in the nation were depositor-owned, but in California and a handful of other states, laws permitted S&Ls to sell stock to the public. In search of shareholder dividends, these stockholder-owned S&Ls pursued a more aggressive growth strategy than conservative, mutually owned S&Ls. By 1967, they controlled 60 percent of the state's S&L assets.[5] The development of stockholder-owned S&Ls also allowed for the creation of S&L holding companies. In February 1955, the New York investment bank Lehman Brothers organized the nation's first S&L holding company, Great Western Financial Corporation. Southern California and particularly Los Angeles, where Great Western was based, was the epicenter of this trend towards larger, stockholder-owned S&Ls. Associations headquartered in Los Angeles County controlled nearly two-thirds of the state's S&L assets.[6] The central role of S&Ls in the growth of Los Angeles made them the most powerful sector of the state's home finance industry. As Governor Brown acknowledged in his July 1966 proclamation of "Savings and Loan Month," S&Ls were uniquely dominant in California, financing over 70 percent of the state's residential mortgages.[7]

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[4] "California's Housing Market: A look at the present and the future," *California Savings and Loan Journal* 39:2 (Feb. 1966), 18.
[5] Mason, *From Buildings and Loan to Bail-Outs*.
[6] C. Jospeh Clawson, Frank W. Barsalou and others, *The Savings and Loan Industry in California* (South Pasadena, CA: Southern California Laboratories of Stanford Research Institute, prepared for California Dept. of Savings and Loan, 1960), Bancroft Library, II-5.
[7] "Governor Brown Proclaims July as Savings and Loan Month," *California Savings and Loan Journal* 39:7 (Jul. 1966), 1.

The home finance industry was a key constituency of Brown's "growth liberalism" coalition. In 1965, Brown told a conference of housing officials, "California, more than any other state, is preoccupied with growth."[8] In the hands of the Brown Administration, growth liberalism understood economic expansion, particularly the creation of a vast home-owning middle-class, as a panacea to social problems, and saw a vital role for government in partnering with private industry to actively encourage this growth.[9] Speaking at the 1966 state Savings and Loan Convention, Brown described the integral role of S&Ls in his vision for the state:

> We are… going to direct our attention to the development of our human resources: the man who needs a job; the boy who must be persuaded not to drop out of school; the mother who worries about sufficient food for her family… Your industry has done much to help us meet those needs. You have taken the load in attracting needed capital to California… in California we are firm believers in the economic principles that have made our nation great. Prices and profits can direct resources and capital into their most productive use.[10]

For Brown, supporting the S&L industry was a way of achieving the social goals of postwar liberalism while maintaining private industry, rather than government agencies, as the public face of home finance.

Even as S&Ls facilitated massive growth on California's urban peripheries, radically transforming landscapes and enabling the movement of capital and people, they advertised themselves as local institutions with personal ties to the areas they served.[11] In California, S&Ls promoted themselves as part of the historical mythologies of white progress and Western expansion. The most vivid examples of this were in the numerous local histories that S&Ls

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[8] Address by Brown, May 10, 1965, "Regional Conf. of Natl. Assn of Housing & Redevelopment Officials, Sacramento, CA," Folder "Mon. May 10, 1965, Regional Conf. of Natl. Assn of Hsg & Redevelopment Officials, Sacto," Carton 77, Edmund Brown Papers, Bancroft Library, University of California, Berkely.
[9] On "growth liberalism," see Robert Collins, "Growth Liberalism in the Sixties: Great Societies at Home and Grand Designs Abroad," in *The Sixties: From Memory to History*, David Farber, ed. (Chapel Hill: University of North Carolina Press, 1994), 11-44.
[10] Remarks by Brown, Mar. 5, 1966, California Savings and Loan Convention, Holiday Inn, Palm Springs, CA, Folder "Sat., March 5, 1966 Savings and Loan Convention," Carton 76, Edmund Brown Papers, Bancroft Library, University of California, Berkeley.
[11] Mason, *From Buildings and Loans to Bail-Outs.*

compiled of their home communities. Often they began with the stories of early white settlement in the state. A history of Pasadena, written for California Federal Savings and Loan, began with a description of Indians living in a virtual state of nature, "unmolested in the company of only coyotes, jackrabbits, and rattlesnakes." But "the coming of the whites would change all of that."[12] In a whiggish succession narrative, "pastoral [Spanish] ranchos" replaced quiet Indian communities and then "enterprising Yankees" with "blunt but 'practical' attitudes" replaced "easy-going and gracious Latin ways."[13] The book featured various symbols of the "progress" that these Yankees brought, from bridges and hotels to hot-air balloons and streetcars. At the end of this history stood California Federal Savings and Loan Association, which "honor[ed] [the] vision and dedication [of earlier European settlers] today, as we too build new institutions."[14]

Another Pasadena Savings and Loan Association presented a similar history. It began in the year Europeans first arrived in Southern California: "The summer of 1769 meant no more to the peaceful Indians living in the small village on the banks of the Arroyo Seco than it did to the verdant growth that was their home… They had no news [of the arrival of Europeans] because their was no news then; no news because nothing was new. Time stood on itself like successive ridges in the mountains to the north."[15] In this history, Indian communities—without history, without time, growing only in the way that nature grew—stood as the opposite of the human-created growth of the white metropolis of Los Angeles. Ultimately, Pasadena Savings and Loan served as both symbol and facilitator of this history of progress. Another S&L history of

[12] Andrew Rolle, *Pasadena, Two Centuries of Growth* (Los Angeles: California Federal Savings and Loan Association, 1969), Bancroft Library, 2.
[13] Ibid., 4.
[14] Ibid., 2.
[15] Pasadena Savings and Loan Association, *Valley of the Hahamog-na: Pasadena Through Two Centuries* (Pasadena: Cole-Hemquist Press, 1952), Bancroft Library, 1.

Southern California skipped the period before Spanish arrival entirely. The "pastoral… simple and feudal" life of Spanish rancheros served as the contrast to the beginning of the "modern" period when "adventurous Americans" arrived and built roads, bridges, and banks. In constructing these narratives of the past, S&Ls attempted to associate themselves with both rootedness and change. In contrast to a timeless Indian past or a sleepy Spanish history, Anglo-American S&Ls helped to create a sense of place defined by change and growth for the millions of uprooted migrants who came to postwar California.

Similarly, in constructing their bank buildings, S&Ls attempted to associate their institutions with both local history and modernity. They incorporated symbols of local culture into their buildings. Inside the clean, concrete walls of a suburban Los Angeles association, behind the teller's line, was a "full-length collage depicting the history of Whittier from native Indians and early Spanish settlers to the modern city we know today."[16] In the South Bay community of Manhattan Beach, Culver Federal S&L built a branch in the shape of a "giant ship" to "blend in with the ocean environment."[17] One construction company advertisement in the *California Savings and Loan Journal* touted its ability to tailor S&L buildings to the local culture of the association's home community with the tagline, "Should your association be a pagoda? ... in Chinatown, yes!" Featuring a photo of an Asian woman in Chinese dress in front of a pagoda, the ad went on to describe branches it had constructed in San Francisco's and New York's Chinatown that had an "Oriental flavor." The buildings' design and furnishings met the "ethnic demands of those Eastern world communities … while behind the scenes the most up-to-date service facilities … make their operation truly modern."[18] In Venice, California, the Great

[16] "History of Whittier Depicted in New Quaker City Federal Savings Quarters," *California Savings and Loan Journal* 39:1 (January 1966), 24.
[17] "Culver Federal 'Launches' New South Bay Branch," *California Savings and Loan Journal* 39:2 (Feb. 1966), 31.
[18] Advertisement, *California Savings and Loan Journal* 39:4 (Apr. 1966), 3.

Western Savings and Loan branch included a giant gondola which harkened back to the community's history as an early twentieth-century beach resort town with canals modeled after its namesake in Italy.

Narratives of progress, western expansion, and modernity drew upon conceptions of masculinity and femininity. In these histories, the images of "adventurous Americans" who replaced "sleepy Indians" and "easy-going Latin ways," represented masculine virility—the ability to remake the landscape. And the men who dominated the S&L industry placed themselves alongside these early Western "adventurers." But a sense of rootedness and home tempered this masculine drive to transform the landscape. It was in service of a feminized domestic sphere—the housewife who needed to feed her children and clothe her family—that the finance industry men sought to remake the California landscape. They often personified Fannie Mae in feminine terms as a metaphor for their sense of service to the feminine domestic sphere. She was a "wealthy young thing," according to a May 1966 *Los Angeles Times* article. "Congress likes her," went the article, "because she helps keep the national housing machinery running, and in Congress that's almost as sacred as motherhood."[19] Fannie Mae provided vast amounts of mortgage money, which was, as Representative Richard Hanna put it, "the mother's milk of the homebuilding industry."[20] Home finance executives continued this tradition after the 1968 Housing Act split Fannie Mae into two, forming Ginnie Mae, the "new girl of mortgage finance," as one Illinois S&L League article referred to it.[21]

Through narratives of Western expansion and modernity, S&Ls sought to resolve potential contradictions between their professed local rootedness and the capital mobility upon

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[19] "Outlook: Fannie Mae Keeps Home Fires Burning," *Los Angeles Times*, May 8, 1966.
[20] 89 Cong. Rec 16,312 (Jul 20, 1966).
[21] "Ginnie Mae: New Girl of Mortgage Finance," *Illinois Reporter* (Apr. 1970), 9.

which they thrived. Indeed, capital mobility was a central feature of the postwar economy, especially for California. On a national level, policymakers in the early postwar era saw capital as a limited resource and confronted policy problems as a series of tradeoffs between different sectors of the economy. The central question was how to best allocate limited capital resources for efficient and stable economic growth and desired social goals. It would not be until the 1980s, when rising interest rates and the liberalization of international capital markets caused massive inflows of foreign capital into the United States, that federal policymakers began to conceive of capital as possibly unlimited.[22] On the state and local level, however, especially in high-growth areas like Southern California, 1960s businessmen and politicians had already begun to think of capital as unlimited. Capital could be imported; it could move from place to place. Two significant trends in the movement of capital emerged: from East to West and from the urban core to the suburban fringe. However, there were far more complex shifts than just these two. Urban and suburban communities in all regions of the country competed for capital resources during a period of remarkable economic growth and capital investment. In certain places, the inflow of imported capital seemed inexhaustible. Local politicians and businessmen envisioned grand possibilities in the economic development of their communities. Federal policy encouraged this way of thinking. Military-industrial spending, social welfare programs and subsidies for suburban development were among the most important examples of government policy redirecting the flow of capital across space and opening up possibilities for specific regions to attract capital once invested elsewhere. This movement of capital and people in the postwar era enabled the growth of S&Ls in California, as demand for mortgages skyrocketed.

[22] Greta Krippner, *Capitalizing on Crisis: The Political Origins of the Rise of Finance* (Cambridge: Harvard University Press, 2011).

Even as they redirected federal spending to new areas, New Deal policymakers, wary of the financial speculation of the 1920s, designed a system that sought to restrict the flow of finance capital across space.[23] The 1933 Glass-Steagall Act separated investment banks from commercial banks. The FHLB system provided the industry with vital support by providing cheap credit, but it also supervised the industry closely. Along with state regulatory bodies, the FHLBB regulated S&L activities to a degree beyond that which comparable regulatory bodies supervised commercial banks, life insurance companies, and other institutions. Regulators monitored advertisements, collected accounting data, and intervened when institutions faced financial instability. Perhaps most importantly, government officials oversaw the geographic spread of S&Ls to an exacting degree. New Deal federal policy limited S&Ls to originating mortgages on property no more than fifty miles from the S&Ls home office. To open a new S&L or an S&L branch office, S&Ls had to acquire a license from federal or state regulators (depending on whether they were state- or federally chartered). Regulators did not merely let the "market" determine when and where an S&L could operate. Instead, applicants had to prove the need for a new S&L office in their proposed location. They had to provide data on the economic and demographic growth of an area, demonstrating adequate demand for mortgages, and the relative lack of existing S&L operations nearby. The geographic regulation of S&Ls made them heavily reliant on local customers for savings dollars. A 1960 report on the California S&L industry prepared for the State Department of Savings and Loan estimated that the average S&L drew a third of its savings dollars from people living less than two miles from its home office,

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[23] The economist K.A. Snowden has argued that the local nature of S&Ls was also a product of their institutional history going back to the late 19th century. Snowden argues that, more important than government regulation, control of S&Ls by local building and real estate interests made these institutions primarily concerned with financing local real estate development. K.A. Snowden, "Building and loan associations in the U.S., 1880–1893: the origins of localization in the residential mortgage market," *Research in Economics* 51 (1997), 227-250.

fifty-six percent from people living within five miles, and seventy-six percent from people living within twenty-five miles.[24]

The New Deal finance system left California S&Ls in a somewhat contradictory position. Though the S&Ls were supposedly a dispersed network of local institutions thriving off of the savings accounts of their home communities, in fact, they were often vital facilitators of capital mobility. In the postwar decades, high demand for housing the state's fast-growing population exceeded the local supply of available mortgage capital. With local pools of capital relatively exhausted by demand, California S&Ls raised the interest rates they offered on their savings accounts and advertised these higher interest rates in newspapers in the Northeast, where the nation's largest capital reserves resided. Large, stockholder-owned S&Ls led the way. In July 1961, Great Western Financial Corporation began advertising its S&L accounts in out-of-state newspapers. Company executives reported that they received $18.8 million in out-of-state funds in the first three months of the ad campaign. Most of these funds, they reported, came from New York City.[25]

Still, individual California S&Ls were often poorly positioned to make their case to investors on the other side of the country. Lacking the in-house resources and knowledge to attract Wall Street investment, dozens of individual California S&Ls combined their efforts under the banner of the Insured Savings Association (ISA). Their newsletters, mailed to prospective investors across the country, touted both the higher rates on California S&L accounts and the vibrant economic growth of the state. The ISA highlighted the partnership between government and business in promoting growth, perhaps best symbolized by the state's network of public and private research universities, which attracted a highly educated workforce and

[24] Clawson and Barsalou, *The Savings and Loan Industry in California*, II-8.
[25] "Financing of Home Purchases Spurs Nation-Wide Fund Flow," *New York Times*, Oct. 29, 1961. All dollar figures have been adjusted for inflation to constant 2015 dollars, unless otherwise noted.

helped to create a high standard of living. Articles described in detail the amazing discoveries of the state's scientific community: "Is the universe exploding? Can that light from the sky really be 8 billion years old? How large is the universe? These and other mind-boggling questions preoccupy a small group of Californians—the scientists and astronomers who have been attracted to southern California by its magnificent astronomical observatories." Investment in an ISA account, the newsletter suggested, offered an opportunity to participate in the dynamism of California's economic and scientific progress while also earning a high return on savings.[26]

Though the typical California S&L drew the majority of its savings dollars from local communities, a growing proportion of savings came from beyond the state's boundaries. The previously-cited 1960 Department of Savings and Loan report estimated that more than three-quarters of the average S&Ls savings dollars came from within a twenty-five mile radius of the home office. Of the remaining quarter, only 8 percent of savings dollars came from Californians beyond this radius, while fully 15 percent came from outside the state.[27] By 1966, state officials estimated that about a fifth of the mortgage capital in the state came directly from sources outside California.[28]

S&Ls dominated the California mortgage market. Yet, the demand for mortgages was so high in California that the Brown Administration also recognized the importance of other types of institutions that provided mortgage capital, especially mortgage companies. Mortgage companies, unlike Savings & Loan Associations, did not retain the mortgages they originated. Instead, they sold them to investors, mainly institutional investors such as insurance companies,

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[26] "Jun-July Insured Savings Association Guide," attachment to letter from Milton E. Levine (Bel Advertising) to Sadler, May 31, 1966, F3739:56, Div. of Savings and Loan, Records of the Los Angeles Office- Subject Files, Advertising 1966, California State Archives.
[27] Clawson and Barsalou, *The Savings and Loan Industry in California*, II-8.
[28] Sadler to Brown, Jun. 7, 1966. F3739:67, California State Archives.

trust funds, and Fannie Mae. Often these investors were not from California. After selling the mortgages, the mortgage company would continue to service the mortgage, collecting payments from the mortgagor and dealing with any problems that arose with the mortgage, such as delinquency or foreclosure. In return, they collected fees before passing along the mortgage payments to the investor. The strict regulation that governed S&Ls did not apply to mortgage companies—they were free to engage in more expansive business practices across a wider geographic area. As Governor Brown thus recognized, mortgage companies served as a vital tool for attracting capital to the California mortgage market from sources outside of the state.[29] These features of the mortgage companies would make them an appealing partner for the Brown Administration when the housing market slumped in 1966.

The 1966 Housing Crisis

The second California "Savings and Loan Month" came during a radically different moment for the industry than the first. In 1966, interest rates rose, mortgage credit grew scarce, and homebuilding ground to a near halt. The slump was a national phenomenon, but California was hit especially hard. S&Ls had less money to lend and turned away thousands of customers seeking mortgages. Throughout 1965 and the first half of 1966, fear of inflation grew. In response, the Federal Reserve raised interest rates. As interest rates rose to levels not seen since the early 1920s, investors moved their money from savings accounts, which provided the majority of mortgage capital, to higher interest rate investments, like CDs issued by commercial

[29] Address by Brown at California Mortgage Bankers Association Convention, El Mirador Hotel, Palm Springs, CA, April 8, 1965, Folder "Calif. Mortgage Bankers Assoc. Convention, El Mirador Hotel, Palm Springs, April 8, 1965, Carton 76, Edmund Brown Papers, Bancroft Library, University of California, Berkeley.

banks, and corporate bonds. By the end of the year, the net savings inflow was $26.8 billion, less than half of the $62.6 billion of 1965.[30] Home construction declined significantly.

Rising interest rates drew a torrent of criticism.[31] The fact that the nation's largest financial institutions, especially those in New York City, led the way in increasing interest rates fed populist anger.[32] In Congress, Representative Wright Patman (D-Tex.), joined by other Southern Democrats, led the fight against high interest rates.[33] The S&L industry also criticized the Fed's move, invoking populist critiques of elite Eastern financial institutions trampling the rights of small, local S&Ls. S&Ls depended on the continuation of low interest rates. They held millions of mortgages that were locked into the low rates of the early postwar era. Unlike other financial institutions, they were dependent on these mortgages as their sole source of income. Lending long-term and borrowing short-term was a potentially dangerous formula. If interest rates rose, as they did in 1966, S&Ls had to raise rates on their savings accounts to keep capital from flowing to other institutions. But they would still receive income at the lower mortgage interest rates of previous eras. In a public statement, Norman Strunk, the executive vice-president of the U.S. Savings and Loan League (USSL) lambasted the Fed as being "overly-considerate of the welfare of the large commercial banks, and less concerned than it should be over the welfare of other businesses and the American people." A few large commercial banks were facing a liquidity squeeze as a result of "irresponsible business practices"—namely their issuance of large

[30] "Strunk and McKeever on 1968 Outlook," *Illinois Reporter* (Jan. 1968), 15.
[31] Chapter 2 will examine the political battles over interest rates in more detail.
[32] FNMA Report, "The Residential Mortgage Market," Apr. 14, 1966, RG 207 - Records of HUD, Robert C. Weaver Subject Correspondence Files, Box 188, FNMA Board Meetings 1966, National Archives II.
[33] For a biography of Wright Patman see Nancy Young, *Wright Patman: Populism, Liberalism, and the American Dream* (Dallas: Southern Methodist University Press, 2000).

sums of short-term certificates that were now coming due. “Under the guise” of fighting inflation, Strunk charged, the Fed was bailing out the big banks.[34]

For California S&Ls, rising interest rates were especially troublesome. The higher rates offered by California S&Ls on their savings accounts, advertised in newspapers like the *New York Times* and *Wall Street Journal,* attracted relatively active, wealthy, and knowledgeable depositors—people likely to move their money when a better opportunity arose. In April of 1966, officials at California Federal Savings and Loan, concerned about the recent outflow of capital from their savings accounts, completed a study of their depositors. They found their typical account holder to be over fifty-five years of age, often retired. They maintained an account of at least $36,500. They usually had accounts at several associations and they usually also held a variety of other investments, such as stocks and bonds. They judged their average accountholder to be fairly typical of other California associations, at least those in large, metropolitan areas. The report argued that federal policymakers misunderstood the industry, because they erroneously believed it was dominated by small savers unlikely to move their money and thus was relatively insulated from larger capital markets. Operating under this assumption, the Fed underestimated the impact of higher interest rates on the S&L industry. The report argued that the Fed should moderate its anti-inflationary policies and allow S&Ls to enjoy an interest rate advantage. It also recommended broadening S&L lending authority beyond current geographical restrictions and into consumer finance.[35] The association’s executives forwarded it to officials in the California State Department of Savings and Loan, where officials

[34] Statement of Norman Strunk, Dec 7, 1965, C.F. FI 8 Interest Rates, 1/15/65 - 12/3/65, Box 50, WHCF, LBJ Library.
[35] Marvin Holen to Leo Bromwhich, May 3, 1966; Phil Barnett to Howard Edgerton, April 19, 1966, F3739:82, California State Archives.

largely agreed with the report's findings.[36] When large commercial banks in New York began raising their rates in 1965 and 1966, these depositors had ready access to higher-yielding investments like CDs and corporate securities. The capital flow from New York to California slowed to a trickle.

Compounding the S&L crisis was a change in federal policy that allowed commercial banks to more effectively compete with S&Ls. New Deal banking policy, through a policy called Regulation Q, provided the Fed with the power to limit the rates commercial banks paid on their accounts. S&Ls, on the other hand, were permitted to pay higher rates, though they faced pressure from the FHLBB to keep rates from spiraling out of control. New Deal policymakers created this rate differential as a way of supporting the specialized home financing role of S&Ls. In December 1965, however, the Fed raised the ceiling imposed under Regulation Q on CDs to the prevailing rate offered by California S&Ls on their savings accounts, effectively abolishing the rate advantage enjoyed by the S&L industry in California. Joseph Barr, the Undersecretary of the Treasury, understood the meaning of this decision. In June 1966 Barr sent a memo to President Johnson's economic advisor, Gardner Ackley:

> [It was] a turning point in the financial history of the United States…[It] reversed about 30 years of recent history by striking away the competitive advantage which the thrift institutions (S&Ls and mutual savings banks) have enjoyed in our economy…assuming that competition is an effective means of channeling economic resources, how far can we let banks, S&Ls and mutual savings banks go in the area of competition and still maintain a system of 14,000 banks and 7,000 thrift institutions? If we allow relatively unfettered competition, can the small banks and the small S&Ls survive?… [It] reversed a national consensus on thrift institutions, homebuilding, and the place of competition in the banking industry. To me it is incredible that such an action by an agency responsible almost to no one could reverse 30 years of history, countless debates,

[36] Sadler to Bromwhich, May 9, 1966, ibid.

> investigations, elections, and deeply rooted beliefs and hopes of the American people. Is this tolerable in a free society?"[37]

Barr cautioned that, "we'd better find some answers we unless we want to drift with history. Andy Mellon's portrait over my fireplace makes me extremely reluctant to drift."[38]

Thrifts could raise their rates above Regulation Q, as some did, but a rate war would be particularly dangerous for thrifts because they relied on long-term, fixed-interest rate mortgages for their income—unlike commercial banks, which had much more diverse investment portfolios. As capital moved out of S&Ls and into commercial banks and corporate securities, S&Ls had less money to originate mortgages. Homebuilding ground to a near halt in California, which relied more heavily on S&Ls than any other state.

Deepening the problem in California was Fannie Mae's response to the housing crisis. In the final quarter of 1965, as interest rates began to rise, Fannie Mae was already seeing the effects of a tightening market. As private investors moved their money from mortgages to securities, an increasing number of mortgage sellers turned to Fannie Mae. The quarter set a new record for mortgage purchases—$2.8 billion on 34,271 mortgages—edging out the previous record set in 1957 when purchases were just under $2.8 billion.[39] By the end of March, executives at Fannie Mae determined that the mortgage "situation [was] at a critical stage."[40] The outflow of investors from the mortgage market left Fannie Mae as the "prime market" for mortgages. Offers from mortgage originators were streaming into Fannie Mae's Washington office, stretching its resources. "If offers continue at the current rate," an internal report warned, "FNMA purchasing capacity will be exhausted in less than five months." Fannie Mae purchases

[37] Memo, Barr to Ackley, Jun. 1, 1966, C.F. FI 5 Credit Loans, 4/21/66 – 9/6/66, Box 37, WHCF, LBJ Library.
[38] Ibid.
[39] FNMA Press Release, Feb. 17, 1967, RG 207 - Records of HUD, Subject Correspondence Files - Robert C. Weaver, Box 247, FNMA Memoranda 1967, National Archives II.
[40] Untitled Report, Mar. 28, 1966, J.S. Baughman to Weaver, Apr. 1, 1966, RG 207 - Records of HUD, Robert C. Weaver Subject Correspondence Files, Box 188, FNMA Board Meetings 1966, National Archives II.

spiked to nearly $5.6 billion, more than eight times the amount it purchased in the first quarter of 1965. Meanwhile, its sales stood near zero.[41] In the second quarter of 1966, purchases dropped to around $3.6 billion as financial institutions made fewer new loan commitments, yet they remained at record highs.[42]

For Fannie Mae, the 1966 crisis highlighted the contradictions of its public-private status. Since its creation in 1938, Fannie Mae's government charter had charged it with providing countercyclical support for the mortgage market. In 1956, Congress had reorganized Fannie Mae, selling half of its shares to private investors, but the other half of its shares were still held by the government and its public charter remained intact. When mortgage money was tight and few other buyers could be found, as was the case in 1966, Fannie Mae was supposed to prop up the market by purchasing large numbers of mortgages. When the opposite was true, Fannie Mae would sell mortgages, helping to keep the market from overheating. Yet to do so would hurt its bottom line, meaning increased government outlays and decreased shareholder dividends.

Politicians like Governor Brown called for Fannie Mae to fulfill its public charter, but the Johnson Administration was concerned with the budgetary impact of Fannie Mae's increased purchases. The president's chief economic advisor, Gardner Ackley, argued that Fannie Mae should reduce the prices it paid for mortgages in the hopes that this would lower the association's need for government cash. Realizing the political backlash that this might cause, he hoped that it could be done in a "low key manner" that avoided "the front page."[43]

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[41] FNMA Press Release, Nov. 10, 1967, RG 207 - Records of Hud, Subject Correspondence Files - Robert C. Weaver, Box 247, FNMA Memoranda 1967, National Archives II.
[42] FNMA Press Release, Feb. 17, 1967, RG 207 - Records of HUD, Subject Correspondence Files - Robert C. Weaver, Box 247, FNMA Memoranda 1967, National Archives II.
[43] Memo, Ackley to Mcpherson, Jan. 10, 1966, C.F. FI 8 Interest Rates, 1/15/65 - 12/3/65, Box 50, WHCF, LBJ Library.

In 1966, the market was tighter and borrowing costs were higher than they had been at any point in the postwar era. The result was significantly diminished corporate earnings and shareholder dividends. “These are unusual times,” remarked Fannie Mae President John S. Baughman.[44] With Fannie’s earnings lagging and its resources stretched thin, some of its largest and most influential shareholders complained to the board about the increasing costs of Fannie Mae borrowing. One of these investors was Philip L. Carret, chairman of the Pioneer Fund, which owned 45,000 shares of Fannie Mae, an amount, he suggested, that “may well be the largest block of Fannie Mae common stock in a single ownership.” Carret charged that Fannie Mae had not reduced the prices it paid for mortgages fast enough to deal with “money market realities.” This, he said, “would seem to indicate that your board is more interested in employing Fannie Mae as an instrumentality for subsidizing mortgage brokers or sustaining unenconomic construction operations than in producing satisfactory results for the common shareholders.” This fear of “political” meddling in Fannie Mae operations, Carret speculated, made potential investors wary of putting their money into the corporation and made it more difficult for current investors to sell their shares. From Carret’s perspective, the public policy, or “political,” goals of the corporation were incompatible with its responsibilities to its shareholders. Either the corporation should be completely privatized and “freed from any possible political domination,” or the government should buy back the shares held by private investors and return the corporation to its pre-1954, wholly-government-owned status. Given the way Fannie Mae had handled the 1966 crisis, Carret asserted that the corporation’s position had been “so far deteriorated” such that the latter was the only viable option.[45]

[44] Ibid.
[45] Philip L. Carret to J.S. Baughman, Oct. 21, 1966, RG 207 - Records of HUD, Robert C. Weaver Subject Correspondence Files, Box 188, FNMA Correspondence 1966, National Archives II.

There was not much Fannie Mae could do, Baughman replied to Carret. "Unlike many organizations which can postpone an expansion of their programs to times when funds are plentiful and borrowing costs are lower," Baughman wrote, "FNMA is required, due to the nature of its business, to finance its activities when borrowing costs are sometimes at their highest." "The nature of its business," was an oblique reference to the fact that, as a government-chartered and partially government-owned corporation, it served public policy goals—not just its shareholders. (Indeed, it faced much public and Congressional criticism that it was not purchasing enough mortgages to ease the crisis.) With this fleeting reference to "the nature of its business" out of the way, Baughman chose to focus on the business sense of Fannie Mae's actions. "Fannie Mae is building up a portfolio of good quality mortgages from which, in normal times, a portion can be sold to good advantage."[46]

Another Fannie Mae shareholder, Robert Whitney, voiced concerns similar to those of Carret, urging Fannie Mae to sort out its public-private identity crisis and ultimately requesting that the government buy back his shares. Baughman responded to Whitney by pointing out the significant benefits of government involvement in Fannie Mae, particularly its original capitalization and its ability to borrow money at cost from the U.S. Treasury to finance its day-to-day operations. In any case, Baughman stated, the corporation was bound by its Congressional charter to "provide supplementary assistance to the secondary market for home mortgages by providing a degree of liquidity for mortgage investments, thereby improving the distribution of

[46] J.S. Baughman to Philip L. Carret, Oct. 28, 1966, RG 207 - Records of HUD, Robert C. Weaver Subject Correspondence Files, Box 188, FNMA Correspondence 1966, National Archives II.

investment capital available for home mortgage financing." Any change in this mission, Baughman pointed out, would require Congressional action.[47]

Reductions in the prices that Fannie Mae paid mortgage sellers had little effect dampening demand. Fannie Mae, which set weekly prices based on market surveys, often lagged behind the market, leaving its prices higher than private purchasers. Thus, Fannie Mae decided to limit its mortgage purchases to those that did not have more than a $15,000 outstanding principal balance.[48] The ceiling would immediately exclude about one-third of the mortgages being offered for purchase.[49] A disproportionate number of these mortgages were in the high-priced California market. In Southern California, where the average price for a new home was $21,000, 80 percent of new homes exceeded the $15,000 limit.[50] Already the tightest mortgage market in the nation even during the relatively loose period of the 1960s, California's mortgage market had the smallest margin for error in 1966. The state's mortgage banks and S&Ls had not built up the reserves of capital necessary to weather the storm. In the first quarter of 1966, housing starts were down more than thirty percent in Southern California from the year before.[51] A survey conducted for a financial periodical called *The Money Market Newsletter* claimed that roughly 50 percent of all S&Ls in the Los Angeles area had completely stopped making new loans.[52]

For Governor Brown, a housing crisis in an election year spelled potential disaster. The crisis threatened to undermine Brown's campaign strategy. Brown hoped to run on the economic growth of the state during his tenure. He highlighted record-breaking employment, wage, and

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[47] J.S. Baughman to Robert Whitney, Nov. 17, 1966, RG 207 - Records of HUD, Robert C. Weaver Subject Correspondence Files, Box 188, FNMA Correspondence 1966, National Archives II.
[48] In nominal dollars. The $15,000 ceiling is $109,000 in 2015 dollars.
[49] Untitled Report, Mar. 28, 1966, J.S. Baughman to Weaver, Apr. 1, 1966, RG 207 - Records of HUD, Robert C. Weaver Subject Correspondence Files, Box 188, FNMA Board Meetings 1966, National Archives II.
[50] Lawrence J. Weinberg, "Industry Made Unfair Target," *Home Builders Journal* (June. 1966), 25. In nominal dollars. The average home price of $21,000 is $152,000 in 2015 dollars.
[51] Brown to Weaver, Jun. 6, 1966, RG 207 - Records of HUD, Robert C. Weaver Subject Correspondence Files, Box 188, FNMA Board Meetings 1966, National Archives II.
[52] Ibid.

profit levels.[53] A housing crisis, however, spelled disaster for the state's construction and other housing-related industries. Furthermore, mortgage shortages severely diminished Californians' access to homeownership. Thus, Brown administration officials worried that the mortgage shortage could cost them the election.[54] With the governor's re-election at stake, the Brown Administration urgently sought to find solutions to the crisis. The second "Savings and Loan" month was less a celebration of the S&Ls' achievements and more a gesture by the Governor to show his support for the industry and demonstrate concern for the housing market. In the words of the California Savings and Loan League (CSLL) president, Edward L. Hansen, it was a sign of a "new attitude towards the savings and loan industry." "The public," Hansen wrote, "has felt the impact of our vitality because they have now had an opportunity to miss it."[55]

Responding to the Crisis

By early May 1966, the risks to the S&L industry and the mortgage market were becoming readily apparent to the Brown Administration. The governor turned first to the federal government for assistance. Given the power of federal agencies—namely, Fannie Mae, FHA and the FLHBB—to shape the mortgage market, it seemed like a natural first step. An injection of federal funds into the mortgage market by the FHLBB or Fannie Mae would be the fastest way to loosen the market. With a tight federal budget, however, Washington was slow to act. As one California real estate consultant noted, "Homebuilding is a creature created by Uncle Sam and

[53] "Records Broken By State's Economy, Brown Reports," *Los Angeles Times*, Aug. 17, 1966.
[54] Sprague to Califano, Oct. 17, 1966, C.F. FI 5-4 Housing 11/18/65 - 10/31/66, Box 41, WHCF, LBJ Library.
[55] "Observations of the President," *California Savings and Loan Journal* 39:7 (Jul. 1966), 3.

every time it has hit a slump the government has primed the pump. … This time, for the first time since World War II, the government decided not to prime the pump."[56]

On May 5, Gareth Sadler, Director of the California Savings and Loan Department, met with members of the California Congressional delegation to discuss ways of dealing with the outflow of capital from the mortgage market, including increasing Fannie Mae's lending authority, FHLBB advances to cover S&L capital shortages, and pressure on HUD to raise interest rate ceilings on homes insured by the FHA.[57] Specifically, the Brown Administration argued for the allowance of regional differentiations in ceilings on the interest rates S&Ls could provide on savings accounts and the prices of mortgages that Fannie Mae could buy. With Fannie Mae nearly absent from the California mortgage market, regulators even contemplated the creation of a "little Fannie Mae" in California to foster secondary mortgage market activity in the state.[58] This idea would circulate within the Brown Administration throughout the summer of 1966, though it would never come to fruition. Nevertheless, it demonstrated the Administration's expansive ambitions for the housing market.

Sadler summarized the crisis in a June 7 letter to Governor Brown.[59] Because the state relied heavily on S&Ls and "imported capital" to finance its mortgages, Sadler wrote, California was more sensitive to rising interest rates. Actions to solve the problem would therefore have to come primarily at the federal level, through changes in monetary and/or fiscal policy, or through support from federal housing agencies. At the state level, Sadler suggested that the Governor encourage more investment in mortgages, particularly from the state's pension funds. In order to make mortgages more attractive to institutional investors, Sadler also proposed that his

[56] "The Homebuilding Outlook," *Los Angeles Times* (Sep. 29, 1966).
[57] Sadler to file, May 9, 1966 F3739:82, California State Archives.
[58] Hempel to Sadler, May 31, 1966, F3739:58, California State Archives.
[59] Sadler to Brown, Jun. 7, 1966. F3739:67, California State Archives.

department help the industry develop methods to sell mortgages on a pool basis.[60] This method would diminish the risk involved in mortgage investment. Individual defaults would have little impact on the pool as a whole. Pooling could attract investors with little knowledge of local mortgage markets. They would only need to assess the risk of the pool as a whole rather than of individual mortgages. S&Ls and mortgage companies would make decisions on where and when to originate mortgages and would handle any problems that arose, such as delinquency or foreclosure.

The primary targets for this pooling technique were pension funds. Pension funds in the U.S. had traditionally invested in low-risk government bonds, but during the 1960s they began to experiment with higher-yield and higher-risk investments like corporate bonds and stocks and real estate. By the early 1960s, two decades of relatively sustained economic growth—including rising corporate profits and real estate prices—had made these higher-yielding investments seem less risky, while a rising cost of living made a conservative investment policy seem inadequate to meet the growing needs of retirees who were living longer. Investment bankers and financial consultants, with much to gain by more aggressive pension fund investment policies in the form of consulting and service fees, argued that pension funds could afford to be more aggressive. One of the most prominent voices for more aggressive investment policies was Paul L. Howell, a financial consultant and former Fellow with the liberal policy research institution the Twentieth

[60] A similar technique, termed "mortgage bonds" or "participation certificates," was used by some financial institutions in the 1920s. Mortgage bonds could cover specific mortgages, pieces of mortgages, or shares in pools of mortgages. By 1930, mortgage guarantee companies and real estate bond houses had issued $2.5 billion of participation certificates for residential mortgages (Grebler, 446). Fraud and speculation plagued the market and it failed following the 1929 stock market crash. See Leo Grebler, D. Blank, and L. Winnick, *Capital Formation in Residential Real Estate* (Princeton: Princeton University Press, 1956); Jerry W. Markham, *A Financial History of the United States: Volume II: From J.P. Morgan to the Institutional Investor (1900-1970)* (New York: M.E. Sharpe, 2002) , 146-147; K. A. Snowden, "The Anatomy of a Residential Mortgage Crisis: A Look Back to the 1930s," Working Paper 16244, *National Bureau of Economic Research* (July 2010).

Century Fund. In 1962, New York City Comptroller Abraham Beame appointed Howell to facilitate a mortgage investment program for the city's pension fund. Writing of the need for a "more dynamic investment policy" for pension funds, Howell argued that restricting pension fund investment to government bonds was an "unnecessary and costly obeisance to an illusory concept of conservatism."[61] Part of the problem, Howell stated, was that civil service pension fund managers were "incompetently trained" investment consultants; they were lawyers, accountants and members of the civil service; they did not have the "proper mental attitude[:] they have been conditioned to play it safe."[62] In the fall of 1962, Howell directed his critique specifically against the California State Employees' Retirement System (SERS). SERS was overly conservative, he argued, because it did not hold any common stock, real estate, or mortgages.[63] SERS was already contemplating a change in investment policy. In 1961, it hired Moody's Investment Consulting to study its policies. Moody's report found that the fund was indeed too conservative and should invest more in common stock and mortgages.[64] Howell and Moody's arguments eventually persuaded SERS to begin experimenting with mortgage investment in 1963.

Union pension funds were also beginning to invest their growing capital reserves in common stock and mortgages. In 1956, the International Ladies' Garment Workers Union hired a young investment banker, Alexander Bookstaver, to diversify its pension fund portfolio, which at that time only included government bonds. Bookstaver quickly invested over $785 million of the fund's $2.7 billion reserve into mortgages with another $314 million in corporate and utility

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[61] Paul L. Howell, "Needed a Dynamic Civil Service Pension Program," *Public Administration Review* 22:4 (Dec. 1962), 185.
[62] Ibid.; Howell, "A Re-Examination of Pension Fund Policies," *Journal of Finance* 13:2 (May 1958), 265.
[63] Howell, "Management of California Pension Funds," *California Management Review* 5:1 (Fall 1962), 33-42.
[64] Governor's Conference on Pension Fund Investment, Jul. 27, 1966, Carton 844, Savings and Loan, July 27, 1966 (only), Edmund Brown Papers, Bancroft Library, University of California, Berkeley.

bonds, raising the fund's annual rate of return from two-and-a-half percent to four percent.[65] His work caught the attention of George Meany of the AFL-CIO, who hired him in 1961 to head a new Department of Investment for the union. Meany and Bookstaver developed a plan to direct $7.5 billion of the union's pension and welfare funds into government-insured mortgages for moderate-income, union-built housing. In the words of the *Palm Beach Post* of Florida, "America's labor leaders were going capitalist in a modern fashion."[66]

Yet, despite forays into mortgage investment by SERS, New York City, the AFL-CIO and a few other pension funds, most pension funds remained conservative through the 1960s, keeping a large majority of their portfolio in low-risk government bonds. When they did invest in mortgages, they were often single, large, commercial developments, like hospitals or hotels.[67] Mortgage bankers and financial consultants continued their push to change investment policies, but their success was piecemeal. In 1966, however, with California's housing industry at a standstill, the Brown Administration stepped into the debate on pension fund management, adding its significant influence with unions to investment bankers' calls for more aggressive pension fund investment. The Brown Administration recycled the arguments made by Howell and Moody's to urge SERS to expand its mortgage investment program and to encourage other pension funds to invest in mortgages as well.

By late March of 1966, officials in the California Department of Savings and Loan were in touch with SERS, discussing ways to expand mortgage investment.[68] They also contacted the California Savings and Loan League (CSLL) to assist in the marketing of mortgages to pension

[65] "Labor's Money; Invested for Purpose and Profit," *Time* (Jan 20, 1961).
[66] "Labor Union Leaders Go Capitalist; Soon to Have Half Billion Assets," *Palm Beach Post* (Mar. 30, 1965).
[67] "State Pension Funds Seek Higher Returns in Stock, Real Estate," *Wall Street Journal* (Jul. 20, 1962).
[68] Lautenberger to Goldstine, Mar. 24, 1966, F3739:86, California State Archives.

funds.[69] In May, the Governor asked Alexander Bookstaver of the AFL-CIO to complete a study of SERS's pension fund investment policies. The Administration got what it expected from Bookstaver: a report that argued SERS investment policies were too conservative and SERS should invest more in mortgages. Brown forwarded the report to SERS's board. The Administration made a carefully worded argument for SERS' mortgage investment: "Although your board's first obligation is to the security and prosperity of the retirement fund, its investment policies do have an impact on the economy of the state; the housing industry in California now plainly needs and can safely absorb additional insured investments of the kind you are continually making."[70] The governor was making a two-fold argument. On one hand, as Bookstaver, Howell, and Moody's argued, the fund should invest in mortgages for its own financial good. On the other hand, the Administration argued that SERS should invest in mortgages for the good of the housing industry and the state's economy at large. This latter argument was clearly why the Governor sought to involve himself in SERS's investment policies to begin with. In his response to the Brown Administration, SERS board member and Bank of America executive Patrick Byrne indicated that he understood the Governor's rhetorical move. Byrne wrote:

> The last sentence of your letter refers to the significant part that a fund with the large financial resources of SERS can play in the economy of California in assisting in the financing of the important home building industry. It also indicates that you are fully aware that the mortgage investment market should be allowed to find its proper investment yield level in relation to other forms of investment, and should not be artificially supported (if it could be) by accelerated investment on the part of SERS… Having said this, we might both agree that, in the present instance, there may be a mutuality of interest between the needs of the state and the needs of the SERS fund.[71]

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[69] Sadler to Hardinge, May 21, 66, F3739:60, California State Archives.
[70] Christian to Fowler, May 10, 1966, F3739:58, California State Archives.
[71] Byrne to Christian, May 24, 1966, F3739:58, California State Archives.

SERS would become an important ally for the Brown Administration in its attempts to convince other pension funds to invest in mortgages. Even as they sought to reshape the mortgage market, engineering the redirection of capital flows to achieve the social and economic goal of rekindling California's housing growth machine, Brown and SERS President Stanley B. Fowler deployed myths of natural, unadulterated market forces to explain their actions.

To head a commission dedicated to courting pension fund investment in mortgages, Brown appointed Milton M. Gordon, a Los Angeles mortgage banker, nicknamed Milton "Money" Gordon by fellow mortgage banker, Raymond Lapin. In the summer and fall of 1966, Gordon "liv[ed] out of a suitcase, running around courting the pension funds."[72] As a mortgage company executive, Gordon had ample experience in the secondary mortgage market. Indeed, his business had much to gain by increased pension fund investment. Some in the pension fund community noted this conflict of interest. Members of the Administration reported to Brown that he was "looked upon with great suspicion and disfavor among most of the people he is supposed to be working with."[73] They noted "one rather snobbish complaint that putting a mortgage broker in charge of this project is a little like putting a medical supply salesman at the head of a committee to investigate the Medicare program." Yet, recognizing Gordon's valuable role in making the case for pension fund investment, the Administration chose not to remove him from his post. Rather, they sought to keep Gordon's work from being "over-publicized."[74]

In July 1966, Raymond Lapin, a San Francisco mortgage banker and a "staunch" Democrat, wrote to the Governor. His letter immediately caught the attention of the

[72] "The Homebuilding Outlook," *Los Angeles Times* (Sep. 29, 1966).
[73] Memo Christian to Brown, Jun. 30, 1966, Div. of Savings and Loan Jan-May, Carton 844, Edmund Brown Papers, Bancroft Library, University of California, Berkeley.
[74] Ibid.

Administration. Lapin had a significant personal financial stake in the housing market, but he deflected his own interests, instead seeking to explain the crisis in terms of Brown's key political target: middle-class homeowners. "Although the savings and loan, the mortgage banking and the home building industries are suffering greatly from the money developments in the economy, in my opinion … your primary area of concern should be this: for the first time, the people of California are finding it extremely difficult and in many cases impossible to sell or buy a house."[75] The Brown Administration received Lapin's message with enthusiasm and he became increasingly involved in the development of policy solutions to the crisis. In October 1966, Brown formalized Lapin's role by appointing him head of the California Economic Development Agency. Created by Brown in 1959, the agency was tasked with facilitating business investment in the state by providing information and assistance to businesses that were contemplating expansion. This broad mandate notwithstanding, Lapin's attention remained focused on the home finance industry.

Even as Lapin highlighted the effects of the crisis on the average homebuyer, the Brown administration was reluctant to publicly explain the crisis in these terms. The workings of the housing market were not readily accessible to most homeowners. Members of the financial industry obscured their work through highly technical language and the creation of a field of experts whose knowledge was imagined by its members to be incomprehensible to outsiders. Anonymous sources in the California's banking regulatory agencies told the *New York Times* that, "the success or failure of their efforts to resolve the 'California problem' will hinge largely on their ability to keep the public in the dark about the true state of affairs in the California savings and loan industry." One "highly placed official" told the newspaper that, "if the public really knew what was going on out there … I don't know what would happen." An anonymous

[75] Lapin to Brown, July 18, 1966, F3739:58, California State Archives.

California S&L chief told the paper "public confidence is a fragile and irrational thing."[76] For Brown, concern that the nature of the crisis required policy changes primarily at the federal level made the Administration wary of publicly sounding the alarm. "We don't want to give the appearance that the Governor can solve this," Sadler wrote in an internal memo.[77]

For Lapin and the Brown administration, the solution would be found in encouraging more "sophisticated methods" of financing mortgages, namely, the transformation of the secondary mortgage market through pooling techniques and institutional investment. What was initially a patchwork attempt to attract pension fund investment to fill gaps created by the outflow of capital from S&L accounts became a vision for a new era in home financing, a move away from the New Deal home finance system. The policymakers and mortgage bankers involved in this transformation justified their actions to each other in Lapin's terms: motivated by an interest for middle-class home-buyers and home-sellers. However, "sophistication" meant obfuscation. Pooling techniques were largely beyond the knowledge of people outside of the home finance industry. By working through the secondary market, the public face of the mortgage market would remain unchanged. Homeowners would still receive their mortgages from many of the same S&Ls that they had in the past. They would still send their payments to the same institutions that originated the mortgage. They would presumably be unaware of the source of the capital that financed their home purchase. And they would also presumably be unaware of the state's role in facilitating this capital flow.

Significantly, as the Brown Administration and the home finance industry worked together to remake the mortgage market, they explained their actions in terms of lessening

[76] "Thrift Units Face California Test," *New York Times* (Jul 17, 1966).
[77] Sadler to Walt, Jun. 4, 1966, F3739:82, California State Archives.

government interference in the mortgage market. The Brown Administration thus put itself in opposition to the attempts of some Democrats to revitalize New Deal interest rate controls as a means of dealing with the housing crisis. Chief among this latter group was Representative Wright Patman (D-Tex.), who considered high interest rates to be "un-American."[78] Directly challenging Patman's proposal to ameliorate the housing crisis through interest rate ceilings, Lapin argued that governmental interest rate ceilings were ineffectual and, in fact, a case of "government tampering" that was "out of tune with market conditions." Regulation was a self-reinforcing cycle akin to "putting a band-aid on top of a band-aid on top of a band-aid." Lapin believed that the seeds of the housing crisis had been sowed long before the Fed raised interest rates in December of 1965. He argued that rising interest rates brought to light systemic problems with a home finance industry that relied too heavily on government protection. Indeed, he thought the Fed had acted too late rather than too soon in raising interest rates. The real solution, Lapin said, was to break from this cycle and find "more sophisticated methods" of financing mortgages, methods that could make mortgages more competitive with other forms of investment for institutional investors.[79]

Pension Funds

In May 1966, the Brown Administration decided to hold a conference for the state's union pension fund managers to urge them to invest in California mortgages. On July 22, 1966, at the International Hotel in Los Angeles, forty-four union representatives, mostly from the state's building trades, gathered to hear why they should be investing more of their pension funds in mortgages. The first group of speakers came from pension funds that had recently begun

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[78] "Martin rebuffs Patman on interest rate rollback," *San Francisco Chronicle*, Dec. 15, 1965.
[79] "Interest rates may go higher," *San Francisco Examiner*, Mar. 18, 1966.

investing in mortgages. Chief among these was SERS. William Payne, an executive officer at SERS, extolled the virtues of mortgage investment, citing the Moody's report as evidence that pension funds could afford to be more liberal in their investment policies. Harold J. Ostly, Chairman of the Board of the Los Angeles County Employees Retirement Association, related his difficulty in convincing members of his board that mortgages were a sound investment. The problem was that most of the board consisted of people without experience as banking executives—"lay people," as he called them. After an initial trial run in mortgage investment, low foreclosure rates further convinced the skeptical board members to relent.[80] Chester R. Bartalini, President of the California State Council of Carpenters, agreed with Ostly that the main obstacle to pension fund investment in mortgages was a lack of knowledge on the part of fund managers. But this should not deter the uninformed union member, for, as Ostly pointed out, "there are experts in these fields that will do the job for you for a small fee and protect your interest very well." Unions just had to tell these experts what they wanted and "let them go to work."[81]

A few of these experts, investment counselors and mortgage company executives, comprised the second group of speakers at the conference. Lack of knowledge, they said, shouldn't stop union pension funds from investing in mortgages because mortgage banks would make it simple and easy. Pension fund managers who feared that foreclosures made mortgage investment risky were merely uninformed, according to these experts. Foreclosures were rare, they said and, as one investment counselor put it, foreclosure "is a routine process that doesn't

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[80] *Governor's Conference on Pension Fund Investment*, Jul. 27, 1966, pg. 11-12, "Savings and Loan, July 27, 1966 (only)," Carton 844, Edmund Brown Papers, Bancroft Library, University of California, Berkeley.
[81] Ibid. 16

involve more than the execution of documents by the client."[82] Mortgage companies were, as one company executive argued, essentially "service organizations," ready to provide straightforward, simplified investment opportunities. Mortgage companies, he said, would direct pension fund money to homebuilders and, in return, these homebuilders would provide a "continuous flow of mortgages" to mortgage companies and pension funds—a virtuous cycle that embodied "our free enterprise system."[83]

Throughout the conference, speakers presented pension fund investment in mortgages as both a sound investment and a moral prerogative. On one hand, William Payne argued that SERS did not "deserve a great deal of acclaim for going into mortgages" because "mortgages are the natural result of evolution in the history of any pension fund."[84] On the other hand, Bartellini argued that pension fund managers had "a moral obligation … to do everything we can to prime this pump without sacrificing our fiduciary responsibilities."[85] Pension funds could simultaneously fulfill the "natural" prerogatives of the market while serving a greater moral good.

Governor Brown was the conference's guest of honor. In his speech he sought to assure his audience that he was sensitive to the plight of business and labor, and that his perspective on the housing crisis was not merely informed by his position as a government official. His past experience as a private attorney gave him "insight into the problems of business and the labor unions." Once Governor, he appointed business and labor leaders to key governmental positions, "so that when you have something that you need or something that you have to take up with government… you have people [in government] that may have faced the same problems [that

[82] Ibid. 28.
[83] Ibid. 30.
[84] Ibid. 5.
[85] Ibid. 15.

you are facing].” Pension fund investment in mortgages, he argued, was a case where the interests of government, business, and labor merged.[86]

By August, a member of Brown’s staff was able to report that the Governor’s “persistent hammering away at the problems of financing homebuilding in the state have scored points not only with the building trades unions but the with leadership of the California Real Estate Association.”[87] Homebuilders and companies that provided construction material joined in the praise of the governor, sending the Governor’s office letters and telegrams applauding his efforts, especially his encouragement of pension fund investment in mortgages.[88] When an article in *House and Home* credited Bay Area homebuilder William T. Leonard with spearheading the effort to attract pension fund money to mortgages, Leonard was quick to write to the editor explaining that Governor Brown deserved the real credit for the effort.[89]

Yet pension fund capital could not flow fast enough in large amounts to solve the crisis. Tight money persisted throughout the nation and especially in California. Heading into the fall election season, California Democrats were increasingly worried that the crisis could damage their chances at the polls. One Democratic building contractor from Southern California’s Inland Empire wrote to Governor Brown expressing his fears that “Republicans are obviously holding back on mortgage money to make the credit squeeze seem even worse. … Democrats are seriously hurt by this.” Worsening the problem, he said, were government regulators overly concerned with the financial stability of their agencies. Americans who were attempting to find a

[86] Ibid. 24.
[87] Memo, Becker to Brown from Becker, Aug. 1, 1966, Savings and Loan, August, Carton 844, Edmund Brown Papers, Bancroft Library, University of California, Berkeley
[88] For example, Becker to Brown, Jun. 23, 1966, Div. of Savings and Loan Jan- May, Carton 844, Edmund Brown Papers, Bancroft Library, University of California, Berkeley.
[89] Letter, Leonard to Brown, Sep 8, 1966, Savings and Loan, Sep., Carton 844, Edmund Brown Papers, Bancroft Library, University of California, Berkeley.

mortgage were becoming increasingly "resentful to [*sic*] Democrats."[90] On September 7, Brown sent a letter to President Johnson describing the crisis as "chaotic and worsening." "As Governor," he wrote, "I have never seen a more critical situation. I know of your efforts to curb inflation, but it does seem to me that the building industry should not bear the whole load."[91]

With no end in sight to the housing crisis, the Homebuilders' Council of California suggested a second Governor's Conference on pension fund investment in mortgages, this one focusing on corporate funds rather than union funds. Brown, sensing danger for his reelection campaign, eagerly approved plans for this second conference. Corporate pension fund managers gathered at the International Hotel on September 30, 1966, to hear arguments from homebuilders, mortgage company executives, and Sherman Maisel, board member of the Federal Reserve, about why pension funds and mortgages made a good match.[92]

The Brown Administration also continued to press the federal government for more assistance. A primary target for the Brown Administration was the FHLBB. Although the FHLBB did not directly control S&L interest rates, they pressured S&Ls to keep rates low by threatening to turn off the flow of cheap federal credit to S&Ls that raised their rates past a certain threshold—5 percent in the summer of 1966. However, some Southern California S&Ls called the FHLBB's bluff and raised rates beyond the 5 percent threshold that summer. Under significant pressure from the S&L industry and the Brown Administration to allow these higher rates, the FHLBB abandoned its 5 percent ceiling, allowing rates in Southern California to climb to 5 1/2 percent.

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[90] Letter Herbert D. Tobin to Brown, Sep. 2, 1966, Savings and Loan, Sep., Carton 844, Edmund Brown Papers, Bancroft Library, University of California, Berkeley.
[91] Brown to Johnson, Sep. 7, 1966, Savings and Loan, Sep., Carton 844, Edmund Brown Papers, Bancroft Library, University of California, Berkeley.
[92] *Governor's Conference on Corporate Pension Fund Investments* Sep. 30, 1966, 6-28, Savings and Loan, Oct., Carton 844, Edmund Brown Papers, Bancroft Library, University of California, Berkeley.

Strong-armed by the California S&Ls, John Horne, the chairman of the FHLBB, threw his support behind the expansion of Regulation Q to the Savings and Loan industry. On September 21, President Johnson signed the Interest Rate Control Act of 1966, which expanded Regulation Q to S&Ls. In a move designed to placate S&Ls, the law codified a 1/4 percent rate differential between commercial banks and S&Ls. It was a compromise for Representative Wright Patman, who had proposed lowering Regulation Q ceilings on commercial bank deposits by an act of Congress. It was also a compromise for the Brown Administration and the California S&L industry, which had argued against any attempt to control the rates of S&Ls. Importantly, the new law allowed for some regional variation in interest rate ceilings, meaning that California S&Ls could set higher rates, but the maximum ceiling of 5 1/4 percent was still 1/4 percent lower than the prevailing rate in Southern California.

On September 10, the Brown Administration achieved a major victory when President Johnson signed into law the Housing Mortgage Credit Act. The bill authorized an increase in Fannie Mae's direct assistance to the housing market through special assistance programs for low-income housing. Homebuilders lobbied Congress heavily for this assistance. Motivated by budgetary concerns, the President's economic advisors convinced Johnson to put the funds on hold, over the objections of HUD Secretary Robert Weaver, who warned of the dire political consequences if homebuilders were not appeased.[93] Instead, Johnson decided to rely exclusively on the second major provision of the Housing Mortgage Credit Act of 1966, which raised Fannie Mae's borrowing authority from ten times its capital-and-surplus to fifteen times its capital-and-surplus, increasing its borrowing capacity by $27 billion. The Administration's decision not to

[93] Schultze to Johnson, Sep. 22, 1966, C.F. FI 5-4 Housing 11/18/65 - 10/31/66, Box 41, WHCF, LBJ.

use both measures drew harsh criticism from the homebuilding industry, members of Congress, and the Brown Administration. Nevertheless, Fannie Mae's increased borrowing authority brought a measure of relief to the California housing industry.

With the increase in its borrowing authority, Fannie Mae decided in early October that it had the funds to raise the ceiling on mortgages it purchased to $17,500 for existing construction and $25,000 on new construction.[94] However, homebuilders would have to agree to a "standby commitment" to assume the mortgage debt in the event that they could not sell the new homes. The Brown Administration and California builders and financiers complained that it was not enough. As one Orange County builder complained to Secretary Weaver, the new policy was "practically worthless to Southern California," where the majority of home prices still exceeded Fannie Mae's new ceilings.[95] A builder from Anaheim complained that the limits did not "enable FNMA to function properly, [*sic*] in California."[96] Governor Brown wrote to the President, telling him that he was "gravely concerned" that the new limits would still "impose a severe burden" on California's housing market.[97] If Fannie Mae did not have the resources to raise the its ceiling across the board, it should allow for regional variations in home prices and raise the limit in higher-priced western states. On October 17, Raymond Lapin led a delegation of state officials and housing industry representatives to HUD to argue for the abolishment of Fannie Mae's ceiling. California's economy was not the only prize at stake, they said. Governor Brown's reelection campaign was also in jeopardy.[98] Within days of the meeting, Fannie Mae removed the "standby commitment" provision. The Brown Administration praised the decision

[94] In nominal dollars. $127,000 and $181,000, respectively, in 2015 dollars.
[95] Albert Solomon to Weaver, Oct. 18, 1966, RG 207 - Records of HUD, Robert C. Weaver Subject Correspondence Files, Box 188, FNMA Correspondence 1966, National Archives II.
[96] Robert Solomon to Weaver, Oct. 19, 1966, RG 207 - Records of HUD, Robert C. Weaver Subject Correspondence Files, Box 188, FNMA Correspondence 1966, National Archives II.
[97] Brown to Johnson, Sep. 15, 1966, RG 207 - Records of HUD, Robert C. Weaver Subject Correspondence Files, Box 188, FNMA Correspondence 1966, National Archives II.
[98] Sprague to Califano, Oct. 17, 1966, C.F. FI 5-4 Housing 11/18/65 - 10/31/66, Box 41, WHCF, LBJ.

and credited Lapin's delegation with the victory.[99] With the ceilings left intact, however, it was only a partial victory for Brown.

As the election drew nearer and the housing crisis persisted, the Brown Administration worked ever closer with the homebuilding industry to draw more funds into the housing market. Members of the Administration were in "almost daily contact" with homebuilders. Developer William T. Leonard reassured Brown that "every member of the homebuilding industry—even the staunchest right-wing conservative—is being made aware of the actions taken by you and your Administration on their behalf."[100] Brown wrote back, "I think our combined assault on the tight money problem proves again what I feel most strongly: that these tough economic problems require the joint attention of government and industry."[101]

Reorganizing the Industry

The New Deal financial system had created a dispersed network of financial institutions, with different types of institutions serving different needs. But in the late 1950s and early 1960s, the financial industry began a round of consolidation that presaged the vast transformations of the 1970s and 1980s. Banks expanded their businesses into new areas like consumer credit and developed new methods of selling Certificates of Deposits (CDs). Financial holding companies purchased a variety of subsidiaries, beginning to knit together some of the institutions that had been torn asunder by New Deal regulations. Representatives of the S&L industry were highly critical of this trend, at least where commercial banks, the industry's main competitors, were

[99] Sprague to Califano, Oct. 19, 1966, C.F. FI 5-4 Housing 11/18/65 - 10/31/66, Box 41, WHCF, LBJ.
[100] Leonard to Brown, Sep. 29, 1966, "Savings and Loan Oct," Carton 844, Edmund Brown Papers, Bancroft Library, University of California, Berkeley.
[101] Brown to Leonard, Oct. 5, 1966, "Savings and Loan Oct," Carton 844, Edmund Brown Papers, Bancroft Library, University of California, Berkeley.

involved. Speaking at a California Savings and Loan League conference, the president of the USSL, C. A. Duncan, Jr., warned, "if we are not careful, this country could end up with all of its financial eggs in one basket." Seeing expansionary commercial bank policy as a threat to the highly specialized S&L system, Duncan argued that it was "essential that specialized financial institutions be preserved," in order to avoid a system where "all of the credit that is involved in the functioning of American business [would be] dispensed on a cold-blooded, market-allocated, dollars-and-cents basis … to whatever sector of the economy or whatever type of borrower [that] will pay the highest price." S&Ls, Duncan argued, served the homeowner, the saver, the "typical factory worker whose wife gets sick or who runs into a financial jam." They served the public interest, not merely the interests of stockholders.[102]

Industry leaders, like Duncan, upheld the image of small S&Ls serving the needs of local communities. But some in the S&L industry were beginning to embrace the trend toward consolidation and expansion rather than fighting against it. A few industry leaders developed proposals to expand S&Ls' lending authority to consumer finance. Edward L. Hansen, president of the CSLL, advanced the idea that S&Ls should become the "family finance center," loaning money for things like appliances and cars.[103] Officials in the California State Department of Savings and Loan saw consumer finance as a way to strengthen the financial stability of S&Ls by making them less dependent on a single source of income: mortgages. When interest rates rose, as they did in 1966, S&Ls had to match rising interest rates on their savings accounts in order to retain savings while still receiving low-interest payments from homeowners who had taken out mortgages when rates were lower. Consumer finance lending would allow S&Ls to diversify their portfolios, making them less vulnerable to the vicissitudes of the mortgage market

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[102] C.A. Duncan, Jr., "Trends in the World of Finance," *California Savings and Loan Journal* 39:4 (Apr. 1966), 16.
[103] Edward L. Hansen, "Revolution in Our Industry," *California Savings and Loan Journal* 39:7 (Jul. 1966), 16.

while expanding into an area where they could lend money on a shorter-term, higher-interest rate basis. In the short term, regulators acknowledged that this could draw funds away from the mortgage market, as associations lent money for consumer goods rather than mortgages. In the long term, they believed that the mortgage market would benefit from S&Ls that were more financially stable.[104]

In 1966, with the S&L industry under significant strain, regulators in the California Department of Savings and Loan also embraced a trend towards consolidation as a possible solution to the troubles of the industry. Some of the state's S&L executives suggested a temporary moratorium on licenses for new associations and new branches for existing associations in order to lessen competitive pressure.[105] Officials in the Department of Savings and Loan disagreed. Though they approved very few licenses during the mid-1960s, officials believed an absolute moratorium would surrender an important incentive for better management by removing the threat of new competition. Instead, they saw mergers and acquisitions as the best way to shore up financially troubled associations.[106] Sadler compared the industry he oversaw with the automobile industry of the 1910s: on the verge of a wave of mergers and acquisitions that would consolidate a previously diffuse industry into a few large firms. With consolidation would come the replacement of the industry's "flamboyant founding fathers" and "freewheeling entrepreneurs" with "professional managers."[107] In the early days of the postwar housing market, the argument went, risk-taking entrepreneurs were needed to crack the market open and expand into new areas, but now these "founding fathers" were in over their heads.

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[104] Report, California Dept. of Saving and Loan, May 23, 1966, F3739:83, California State Archives.
[105] Marion Donahoe to Sadler, Sep. 16, 1966, F3739:84, California State Archives.
[106] Harrison to Sadler, Apr. 22 1966, F3739:81, California State Archives.
[107] "Thrift Units Face California Test," *New York Times* (Jul 17, 1966).

Their "freewheeling" ways had been good for a emerging market, but now their risk taking had produced many "problem" S&Ls. One S&L executive called the postwar years "the teenage days when we were living in our own world."[108] Low interest rates, a booming economy, and a wide open market had allowed for a relatively carefree attitude among S&L executives. Now, competition from commercial banks, the securities market, and other large, financial institutions were forcing S&Ls to "mature," to become more "professional," and consolidate.

In the spring of 1966, Abner Goldstine, deputy commissioner of the state's S&L Department, tasked financial specialist Justin Rose with producing a report on S&L holding companies. In August, he completed the study and reported that corporate holding companies were "for the most part, vastly undercapitalized." They had taken on vast amounts of bank debt to finance their growth. Rather than rejecting the holding company model, however, Rose argued that the solution for troubled holding companies was another round of expansion and consolidation.[109]

On October 3 and 4, Rose met with officials from the FHLBB to discuss the financial instability of S&L holding companies. FHLB staff members were gravely concerned with the amount of short-term debt holding companies were taking on, especially in light of the long-term, fixed-rate nature of mortgages, their primary source of income. Most troubling was that some holding companies were dipping into the capital reserves of their subsidiary S&Ls to pay off their debt. Regulators had originally imagined that holding companies would be able to provide an important source of capital reserves for their subsidiary associations. Often the reality

[108] Edward F Baumer, "New Opportunities for Savings Development," *California Savings and Loan Journal* 39:12 (Dec. 1966), 17.
[109] Rose to Sadler, Aug. 25, 1966, F3739:83, California State Archives.

turned out to be the opposite: capital was flowing from subsidiaries to the parent holding company.[110]

After this meeting, Rose expanded upon his comments in another memo to his superiors. A number of financial companies (holding companies, commercial banks, S&Ls) were experiencing significant strain because of "unrealistic lending policies" that led to "bad loans, illiquidity and undercapitalization." Not only should regulators encourage further consolidation of the S&L industry to shore up troubled associations, they should also "enlighten, if not direct, the industry concerning the advantages and merits of the so-called 'department store' of finance approach." The short- and intermediate-term lending practices of commercial banks were complementary with the long-term loans of S&Ls. But the "ideal holding company" would not stop there. It would include a wide variety of financial subsidiaries, such as real estate marketing and investment, small business investment, equipment leasing, and insurance, to diversify the company's portfolio.[111] In the fall of 1966, the Brown Administration had little time to achieve this "department store of finance" model, but the ideas that Rose proposed would be fulfilled in the coming decades.

Conclusion

Governor Pat Brown's emphasis on the economic growth of California was not enough to overcome Ronald Reagan's challenge. Reagan successfully campaigned on a message of reestablishing a social order that had supposedly been lost on the streets of Watts and the campus

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[110] L. M. Walters to Horne and Greenebaum, n.d., F3739:48, California State Archives.
[111] Rose to Executive Committee, Oct. 31, 1966, F3739:84, California State Archives.

in Berkeley.[112] Increased Fannie Mae secondary mortgage-market operations and interest rate controls helped to ease the crisis, but these were only palliatives. The fundamental economic problems that caused the crisis remained. The mortgage market still relied largely on a low interest rate environment to attract capital. Inflation and interest rates would become even greater concerns in years to come. These problems would come to a head in 1968, a year in which the nation faced a currency crisis, a worsening situation in Vietnam, and another slowdown in the housing market. In that year, the memory of 1966 would guide policymakers in forging a "new era in home finance."[113]

In July 1967, President Johnson appointed Raymond Lapin as the new president of Fannie Mae. Lapin set out to change the way Fannie Mae did business and to achieve the goals formulated by the Brown Administration in 1966. For Lapin, Fannie Mae's decision to place ceilings on its mortgage purchases during the crisis represented the shortcomings of the corporation's contradictory public-private status, and convinced him that Fannie Mae needed to become more like a private investment bank. It had to be freed from its Congressionally limited borrowing authority, and it needed a way to raise money even in tight markets.

Federal policy during the postwar era facilitated the movement of people and capital to California. It also created the expectation of unlimited economic growth. Yet the New Deal system relied on limits and barriers to regulate the financial industry and imagined an economy defined by tradeoffs and compromise. It was a problematic contradiction for the growth liberals of California. As long as the unique moment of U.S. hegemony in the world economy persisted, guaranteeing relatively robust economic growth without worries of inflation and rising interest

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[112] Matthew Dallek, *Ronald Reagan's First Victory and the Decisive Turning Point in American Politics* (New York: The Free Press, 2000).
[113] Lyndon B. Johnson, "Special Message to the Congress on Urban Problems: 'The Crisis of the Cities,'" Feb. 22, 1968, *Public Papers of the Presidents: Lyndon B. Johnson 1968-1969* (Washington, DC: Office of the Federal Register, National Archives and Records Service, General Services Administration, 1970), 253.

rates, this contradiction lay dormant. But as the economies of Western Europe and Japan rebounded and the United States became bogged down in an expensive war in Vietnam, U.S. economic world hegemony was jeopardized. As inflation became more worrisome and interest rates rose, the capital flow to California shut down and the contradictions between limits and growth became apparent.

During the following decades, the rest of the U.S. would begin to look a little more like California. The vast capital flows that sustained California's booming mortgage market in the 1950s and 1960s made it a "debtor state" in an increasingly "debtor nation."[114] To maintain robust economic growth and fulfill the social promises of postwar liberalism, the state relied on vast amounts of mortgage debt, much of it provided by capital from New York and other Eastern capital centers. When rising interest rates endangered this capital flow, California policymakers turned to the finance industry to develop ways to engineer an ostensibly never-ending flow of capital into the state's growth machine.

Most popular and academic accounts of the origins of the 2008 housing crisis have remained focused on the past thirty years, placing it within a history of "financialization" and the rise of Reaganite conservatism and Clinton-era neoliberalism since the 1970s. They parallel a larger body of history that situates the turn away from a New Deal order in the 1970s and 1980s. This literature imagines the most important actors in this transformation to be on the conservative side of the political spectrum—whether it be grassroots movements, intellectuals, businessmen, or politicians (most notably Ronald Reagan). But, 1960s growth liberals like Pat Brown played a crucial role in steering the country away from the New Deal order in both

[114] Louis Hyman, *Debtor Nation: The History of America in Red Ink* (Princeton: Princeton University Press, 2011).

political and economic terms. The tension between the economic expectations of an economy based on growth and the limits imposed by New Deal regulations was a dilemma of postwar liberalism. And so it was perhaps no surprise that liberals would be in the vanguard of the "financialization" of the economy.

Chapter 2

"The Magna Carta to Liberate Our Cities": The 1968 Housing Act

In November 1967, Raymond Lapin, the new president of Fannie Mae, described the home finance industry as "an old Model T on a modern freeway—the rest of the world is passing it by." But, he said, "there was a new determination to redesign [it]… into a modern vehicle." Lapin claimed that the current method of financing mortgages left Fannie Mae in a dilemma. Whether it borrowed money from the Treasury or the private credit market, the increased demand for funds would serve to push up short-term interest rates and thus further tighten the mortgage market as investment capital moved from deposit accounts to higher-yielding securities, such as corporate stocks and bonds, a process called disintermediation. By contrast, the "modern" way of financing mortgages, according to Lapin, would break down the barriers erected during the New Deal between savings accounts and mortgages, on the one hand, and Wall Street securities markets, on the other hand. Transforming mortgages into securities, Lapin suggested, would stop the "self-defeating, circular process" of disintermediation.[1]

Over the course of the following year, Lapin and the Johnson Administration would lead a campaign to transform the nation's home finance system. From the start of his tenure, Lapin marshaled his experience in California to lobby Congress and the Johnson administration for a reconfiguration of the mortgage market. The 1968 Housing Act fulfilled much of Lapin's vision.

[1] FNMA Press Release, Nov. 13, 1967, RG 207 - Records of HUD, Subject Correspondence Files, Robert C. Weaver, Box 247, FNMA memoranda 1967, National Archives II.

The act reorganized Fannie Mae into a privately owned and for-profit corporation but maintained its government support and subsidies. Most importantly, it gave birth to the mortgage-backed security market.

The 1968 Housing Act coincided with the Fair Housing Act of the same year. The Fair Housing Act outlawed racial discrimination in the housing market, but it addressed only individual acts of discrimination by realtors and lenders rather than broad patterns of systematic discrimination and segregation. Insufficient enforcement by federal agencies combined with the difficulty of proving acts of discrimination severely undercut the Fair Housing Act's efficacy.[2] Just at the moment that the Civil Rights Movement had won a significant victory in the Fair Housing Act, the 1968 Housing Act set in motion a transformation of the home finance industry that reduced the importance of individual, local actors in determining where and to whom to lend. In the following decades, the Securitized System relied more on broad patterns of class and racial segregation than local color lines and individual decision-makers in its distribution of mortgage funds. The emergence of securitization thus undercut the ability of the Fair Housing Act to address racial discrimination and segregation.

The dilemma for Democratic Party leaders in the 1960s was to deliver on the promise of the American Dream—create a nation of homeowners—while cutting taxes, waging the Vietnam War, and maintaining the global financial supremacy of the U.S. By the latter half of the decade, the simultaneous pursuit of all of these goals overheated the economy and contributed to fears of inflation. Policymakers believed that either fiscal or monetary restraint was needed to quell inflation and preserve the Dollar's status as the world's dominant currency. But they could not agree on which path to take. The Johnson Administration was loath to cut spending on the

[2] Christopher Bonastia, *Knocking on the Door*; Charles Lamb, *Housing Segregation in Suburban America Since 1960* (New York: Cambridge University Press, 2005); Mara S. Sidney, *Unfair Housing: How National Policy Shapes Community Action* (Lawrence: University Press of Kansas, 2003).

military or domestic programs, and they were reticent to support a tax increase in light of popular and congressional opposition. With Congress and the White House deadlocked on fiscal measures, the Fed took action to raise interest rates. Beginning in 1965, interest rates rose to postwar record levels. But monetary restraint failed to fully solve the problem. In 1968, a quickly weakening Dollar fueled a run on gold. In the words of historian Robert Collins, it was "the most serious economic crisis since the Great Depression."[3] In June 1968, Congress and the White House finally agreed to a tax surcharge in combination with a $40 billion cut to domestic programs.[4] By the fall of 1968, both fiscal and monetary policy had quelled the crisis for the time being. But rising interest rates had already taken a severe toll on the mortgage market and convinced the Johnson Administration that the home finance system needed significant reforms.

Two other problems pushed President Johnson and congress to support Lapin's solution. As Sarah Quinn has noted, the origin of the mortgage-backed security in 1968 was the result of new government accounting methods that added Fannie Mae's debt to the federal budget.[5] Securitization and the privatization of Fannie Mae offered a way to remove Fannie Mae's mortgage debt from the federal budget. Additionally, Louis Hyman argues public and Congressional support for the 1968 Housing Act was built on Johnson's promise that it would help solve "the crisis of the cities"—symbolized by the African American urban insurrections that spread throughout the country in the late 1960s.[6]

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[3] Robert Collins, "The Economic Crisis of 1968 and the Waning of the 'American Century," *The American Historical Review* 101:2 (Apr. 1996), 396.
[4] All dollar amounts are in constant 2015 dollars unless otherwise noted.
[5] Sarah Quinn, "Government Policy, Housing, and the Origins of Securitization, 1780 -1968" (PhD diss., Sociology, University of California, Berkeley 2010).
[6] Louis Hyman, "American Debt, Global Capital: The Policy Origins of Securitization," in Niall Ferguson, Charles S. Maier, Erez Manela, and Daniel J. Sargent, eds., *The Shock of the Global: The 1970s in Perspective* (Cambridge: Belknap, 2010), 128-142.

Lapin found allies among home finance bankers, including many from California, who sought a mortgage market where capital could flow more freely across spatial boundaries, one that more closely resembled the securities markets of Wall Street. As the new president of Fannie Mae, Lapin was uniquely positioned to carry out this mission to revolutionize the home finance market. Under his direction, the privately owned Fannie Mae would ostensibly deploy the "free enterprise system" and break away from its New Deal roots. Just as important as the freedom from the federal budget that the new Fannie Mae would enjoy, however, was the implicit backing of its mortgage portfolio by the federal government. Armed with this government backing and the new financial tool of mortgage-backed securities, Fannie Mae and its sibling institutions Ginnie Mae and Freddie Mac would come to dominate the home finance industry, holding more than half of all mortgage debt in the U.S. by the 2000s.[7]

Lapin was part of a cohort of businessmen and economists advising the Johnson administration that the New Deal finance system was outdated. The growing conflict in Vietnam and the 1964 tax cut had put pressure on the federal budget and stoked inflationary pressures. Johnson's advisors were also concerned about maintaining the Dollar as the international reserve currency. They therefore accepted, sometimes begrudgingly, that the nation would have to enter a period of higher and more volatile interest rates. But they recognized that the cost of higher interest rates would not be spread evenly though the economy. The housing industry's reliance on the highly specialized and localized thrift industry made it especially sensitive to interest rate volatility. The industry would suffer dearly in this environment without new legislation. For Johnson and other liberals, this was an especially difficult problem because homeownership was a central promise of both the New Deal and the Great Society.

[7] Daniel Immergluck, *Foreclosed: High-Risk Lending, Deregulation and the Undermining of America's Mortgage Market* (Ithaca, N.Y.: Cornell University Press, 2009).

The key, they decided, was making the home finance industry more like Wall Street. Quite the opposite of the thrift industry, Wall Street thrived on higher interest rates. In an era when federal ceilings capped savings deposit interest rates, securities investment offered the possibility for greater returns. And a strong Dollar was vital to Wall Street's role as financial capital of the world. If housing could tap Wall Street's capital markets, with mortgages transformed into securities and traded like corporate stock, housing could ride the decade-long bull market. Instead of suffering in its isolation from capital markets, undergoing periodic and devastating downturns every time interest rates rose, the housing market could be integrated with the rest of the finance industry. Consolidation, they argued, would bring efficiency and destroy the pattern of cyclical disintermediation.

Some Congressional Democrats, led by economic populists such as Representative Wright Patman, Chairman of the House Committee on Banking and Currency, and Senator Albert Gore, Sr., did not accept the need for higher interest rates. A few of them publicly expressed outrage on the floor of Congress, labeling the administration responsible for the Fed's actions.[8] Much of their talk was polemic. Attacking eastern financial elites made good political press. But that's not to say their vitriol was dishonest. For Democrats such as Patman and Gore, the administration's acquiescence to higher interest rates represented a betrayal of a central tenet of what the Democratic Party stood for. They offered an alternative: reinforcing the New Deal's regulation of the finance industry and supplementing it with direct controls on prices and capital inflows in order to combat inflation.[9]

[8] For example, 89 Cong. Rec. S19,442 (Aug. 16, 1966) (statement of Sen. Gore).
[9] Ackley to Johnson, Sep. 6, 1966, , "Re: meeting with Gore and Fowler on interest rates," FI-8 Box 43, WHCF, LBJ Library.

The Johnson administration walked a fine line between embracing higher interest rates and openly opposing them. In public, officials expressed "concern" about the effect of higher rates.[10] In private, they vacillated on the timing and public relations of the Fed. But even if they disagreed with the Fed's decisions, they were wary of making interest rates a political issue. They accepted that the Fed should be independent and, moreover, that monetary restraint was necessary given Congressional intransigency on taxes, the situation in Vietnam, and the need to maintain the dollar's supremacy.

For Johnson's economic advisors, the answer to the dilemma was embracing the financial power of the United States. By opening the home finance system to Wall Street capital, mortgage securitization would break the link between high interest rates and devastation in the housing industry. But growth liberals could not have it all. In their turn to finance, they left behind the long-held populist tradition of distrusting Wall Street and promoting easy money. Not all Democrats in the history of the party had been enemies of finance. Anti-Wall Street populism, however, had been a vital constituency of the Democratic Party from Andrew Jackson to William Jennings Bryant. In the 1960s, however, growth liberals quietly defeated this wing of the party. In the decades that followed, few mainstream Democrats articulated a populist economic program that emphasized easy money.

[10] "Johnson Rebuts Truman on Peril to Economy in Interest Rise," *New York Times*, Aug. 30, 1966.

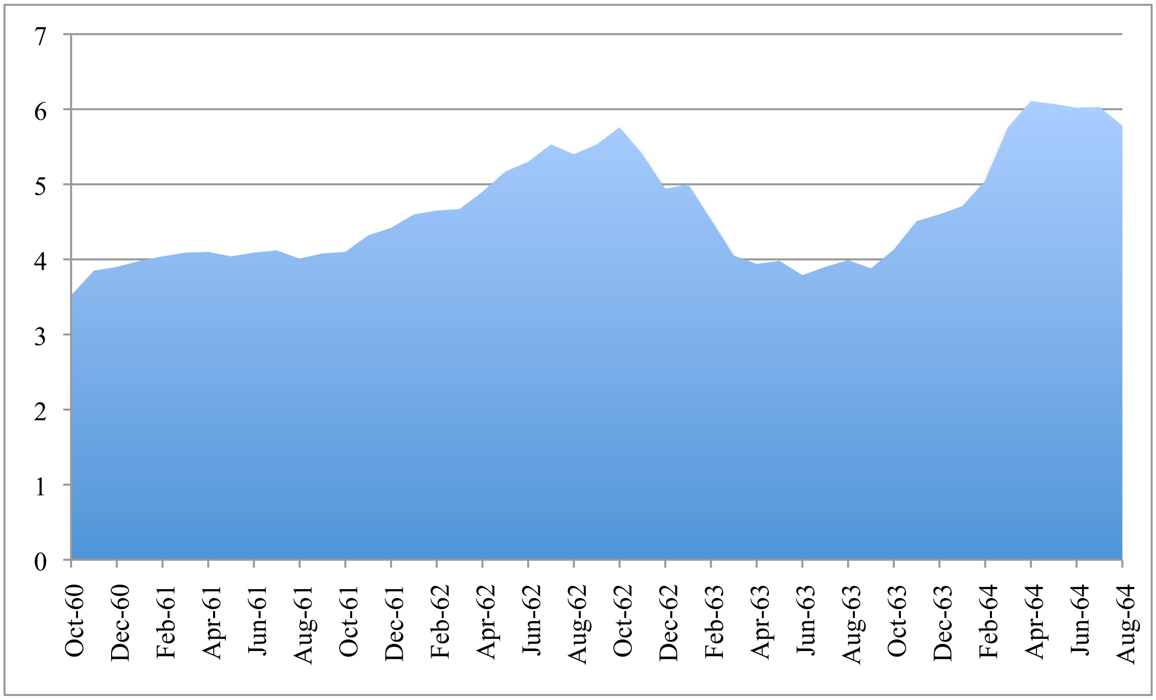

Figure 2.1. Effective Federal Funds Rate, Nov. 1964- Sep. 1968.
Source: Board of Governors of the Federal Reserve System, "Effective Federal Funds Rate,"

https://research.stlouisfed.org/fred2/data/FEDFUNDS.txt. (accessed Mar. 17, 2015).

The Problem of Interest Rates

Throughout his presidency, Lyndon Johnson struggled to allay concerns over rising interest rates voiced by economic populists in Congress, most importantly, Rep. Wright Patman. Patman was perhaps the strongest Congressional advocate of an economic populist tradition within the Democratic Party that stretched back to the late nineteenth-century and William Jennings Bryan.[11] He was also an old friend of Johnson. Johnson was more sympathetic to Patman than his own advisors. In one telephone conversation, Johnson explained to Patman that political considerations precluded his direct, public involvement in debates over monetary policy. But in

[11] Nancy Young, *Wright Patman: Populism, Liberalism, and the American Dream* (Dallas: Southern Methodist University Press, 2000).

the same conversation, he endorsed Patman's view that banks were to blame for driving up the cost of money and encouraged Patman to challenge his own Treasury Secretary, Henry Fowler, on the issue, as long as he did not mention the President's role in encouraging him to do so.[12]

In December 1964, the Fed raised the federal funds rate to the highest level since the Second World War, excepting a brief period in 1959 and 1960. The administration saw the Fed's decision to raise interest rates as "unwelcome" for domestic policy reasons but recognized its importance to bolster dollar exchange rates.[13] Patman had no sympathy for the Fed, and he communicated his outrage to the White House. He urged the president to assert control over the Fed, arguing that the Fed's "claim on independence would make it a fourth branch of the Government, in violation of the Constitution." According to Patman, the Fed represented an anti-democratic oligarchy working in the interests of eastern banking elites. In raising interest rates, "the Federal Reserve can create far more poverty than can be eliminated by your entire anti-poverty program," Patman told Johnson in December 1964.[14] He specifically cited the increased cost of mortgages and other borrowing on the working class American family. Ackley drafted a letter from the President to Patman designed to "hold him at bay."[15] In the letter, Johnson described the Fed's actions as "unfortunate." "Of course, I regret any increase in credit costs at this time," Johnson wrote. But, the president also appeared to support the Fed's decision: "The Federal Reserve came to the reluctant conclusion that an increase in the United States discount rate was required as a precautionary measure. The action by the Federal Reserve was intended to show our determination to protect the dollar and preserve the smooth functioning of the

[12] Johnson Conversation with Wright Patman on Mar 07, 1966 (WH6603.04), Lyndon B. Johnson Presidential Recordings, The Miller Center at the University of Virginia, http://millercenter.org/presidentialrecordings/lbj-wh6603.04-9848 (accessed Mar. 2, 2015).
[13] Ackley to Johnson, Nov. 11, 1964, "The impact of the discount rate increase on our prosperity," C.F. FI-8 9/1/64 - 1/14/65, Box 50, WHCF, LBJ Library.
[14] Letter, Patman to Johnson, Dec. 1, 1964, C.F. FI 8 9/1/64 - 1/14/65, Box 50, WHCF, LBJ Library.
[15] Memo, Ackley to Johnson, Dec. 8, 1964, C.F. FI 8, 9/1/64 - 1/14/65, WHCF, LBJ Library.

international financial system."[16] Patman remained unconvinced. In March 1965, he formed an unofficial steering committee of seventy-two House Democrats to oppose rate increases. Treasury Secretary Dillon wrote to President Johnson in support of current monetary policy and accused Patman of "raising the specter of radical changes in Federal Reserve policy and structure that are unwise or unnecessary." Dillon worried that Patman's steering committee would stoke business and financial opposition.[17]

During 1965, the Administration became increasingly troubled by the effect of high interest rates on the domestic economy. But they were also concerned about taking on Wall Street. New Treasury Secretary Henry Fowler suggested a behind-the-scenes approach to convince banks not to raise their prime rates. "I do not want to put you in the position of personally intervening on a frontal basis with market forces," Fowler told Johnson in August.[18] Treasury Undersecretary Paul Volcker voiced opposition to pressing bankers to maintain rates. He warned Fowler, "overt intervention is likely to raise many more serious problems in terms of interfering with normal market processes." Moreover, Volcker argued that the growing conflict in Vietnam would only add to the pressure to tighten monetary policy in the near future.[19]

Meanwhile, Fed Chairman Martin sought to allay President Johnson's concerns about higher interest rates:

> too much emphasis is being put on interest rates. The real problem is to keep funds flowing freely and effectively to sustain healthy progress in the economy. Whether interest rates move a bit higher—or a bit lower—is not of cardinal importance to the economy. What is important is whether rates are allowed to respond to market forces so that an effective flow of funds is assured. The trouble

[16] Letter, Johnson to Patman, Dec. 10, 1964, Ibid.
[17] Memo, Dillon to Johnson, Mar. 31, 1965, C.F. FI 8, 1/15/65 - 12/3/65, Box 50, WHCF, LBJ Library.
[18] Memo, Fowler to Johnson, Aug. 27, 1965, Ibid.
[19] Memo, Volcker to Fowler, Aug. 27, 1965, Ibid.

> confronting us is that rate ceilings—governed by policy determinations—are proving obstacles to the flow of funds in accordance with natural forces.[20]

Council of Economic Advisors (CEA) member Gardner Ackley, however, expressed concerns that rising rates might dampen the domestic economy. Furthermore, he was confident by September that the dollar's position had been strengthened and "the budgetary impact of Vietnam" was "unfounded."[21] He dismissed the argument that rising rates were a product of "natural market forces" as "sound[ing] like the blossoming of the daises."[22] Through the fall of 1965, Ackley campaigned against higher rates.

In December 1965, the Fed raised rates again, this time surpassing the previous postwar record set in December 1959. In response, the Johnson administration attempted to walk a fine line between endorsing the increase and opposing it. The CEA counseled the president against doing either. Ackley suggested that the president say nothing: in light of inflationary concerns, they couldn't just "blast the banks." On the other hand, they couldn't "bless" the increase "in view of the popular feeling about high interest rates."[23]

By January 1966, Ackley had reversed his earlier opposition to higher rates. "The booming state of the economy," he wrote to the President, "makes it clear that money shouldn't be any easier and may have to get still tighter to help keep things from boiling over." According to Ackley, the Fed's decision was "badly timed and poorly handled [because business] concluded that inflation must be here, since the fed seemed so panicky… borrowers guessed that still higher interest rates were in the wind." Regardless of the specifics, Ackley endorsed the Fed's view that the economy was in danger of overheating and higher interest rates might be needed in the near

[20] Memo, Martin to Johnson, Oct. 6, 1965, Ibid.
[21] Memo, Ackley to Johnson, Sep. 16, 1965, Ibid.
[22] Note, Ackley to Johnson, Sep. 10, 1965, Ibid.
[23] Memo, Ackley to Johnson, C.F. FI 8, Box 43, WHCF, LBJ Library.

future to combat inflation. “We don't have to bless high interest rates publicly,” he said, “but we will have to live with them, at least for awhile.”[24]

Patman continued to express frustration with Democratic Party leaders that they did not take a clearer stand against high interest rates. In 1966, when the party’s platform failed to include easing credit availability, Patman was deeply disappointed. He wrote to Democratic National Committee chairman John Bailey: “low interest rates and sound monetary policy have been prime bulwarks of the Democratic Part throughout this century.”[25] Others in Congress agreed. Representative Ullman wrote to Johnson, “The economic and social gains of the past six years are in serious jeopardy today because of skyrocketing interest rates and the critical imbalance in the national money supply. As a member of the Ways and Means Committee… I must hold this administration responsible for the interest rate crisis. Without a cohesive program, this administration is floundering in monetary policy. In effect, the administration is abdicating to [Fed Chairman] William McChesney Martin the responsibilities for economic policy.”[26]

Despite Congressional opposition, the Fed continued to raise rates during 1966. In August 1966, the effective federal funds rate stood at 5.53 percent, well beyond anything seen in the postwar era. Former President Harry Truman publicly condemned the increase and warned that it could lead to “recession or depression.”[27] In response, Johnson said he was also “concerned about the interest rate rise and what it means to many Americans.” But he denied that the economy was in danger. Rising interest rates were a sign of economic “strength, not weakness.” Johnson refused to openly attack the Fed’s decision, only saying that there were

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[24] Memo, Ackley to Johnson, Jan 18, 1966, C.F. FI 8, 1/15/65 - 12/3/65, WHCF, LBJ Library.
[25] Letter, Patman to Bailey, n.d. (Mar.-May 1966), Ibid.
[26] Letter, Ullman to Johnson, Jul. 13, 1966, C.F. BE 5 6/1/66 - 7/14/66, WHCF, LBJ Library.
[27] “Johnson Rebuts Truman on Peril to Economy in Interest Rise,” *New York Times*, Aug. 30, 1966.

"better ways" than monetary restraint to curb inflation—probably an oblique reference to a tax increase which the administration was not yet willing to openly support.[28]

Senator Albert Gore took to the Senate floor to attack the Administration's acquiescence to rising interest rates. "Johnson interest rates are higher than Hoover rates," he noted. Indeed they were higher than anything seen since the 1920s. "Franklin Roosevelt would turn over in his grave… Roosevelt ran the moneychangers out of the temple and financed a war at reasonable interest rates. Harry Truman did the same thing. Now the moneychangers are back in the temple and we have the highest interest rates since the administration of Warren G. Harding." "Who benefits from [higher rates]?" Gore asked, " Not the American people. Not the small businessman, whose profits are being squeezed. Not the consumer… Not the Democratic Party… Who benefits are the relatively few who have inherited or accumulated wealth and who are enjoying a privilege under this policy almost tantamount to the privilege of levying taxes upon the American people and pocketing it."[29] To combat inflationary pressures, Gore proposed direct federal control on capital outflows, a measure that Ackley advised President Johnson was "pretty extreme."[30] He also proposed a "national usury rate" of six percent and direct capital controls to keep capital from leaving the U.S. in search of higher rates elsewhere. Patman argued that Congress should strip the Fed of its independence, giving Congress and the President more direct control over interest rates.

Publicly, the Administration critiqued private bankers' decisions to raise the prime rate, but privately they viewed the increase a result of a justified policy of monetary restraint by the Fed. "Gore is basically right about the level of interest rates," Ackley told President Johnson, acknowledging the fact the country was experiencing credit stringency unseen since the 1920s.

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[28] Ibid.
[29] 89 Cong. Rec. S19,442 (Aug. 16, 1966) (statement of Sen. Gore).
[30] Memo, Ackley to Johnson, Sep. 6, 1966, C.F. FI-8, Box 43, WHCF, LBJ Library.

Yet, he said, if the Fed hadn't raised rates it "would have made monetary policy the engine of inflation it would also have destroyed all confidence by the bankers and central bankers of the world in our willingness to control inflation, and would have precipitated a flight from the dollar." Furthermore, Ackley acknowledged that Roosevelt was able to fight a war with low interest rates, but this was only possible because of higher taxes and wage and price controls.[31] Unless the administration was willing to campaign for these measures, monetary policy would have to suffice as a wartime anti-inflationary policy. By December 1966, interest rates had leveled off. During the spring of 1967, they began to fall. But the long-term specter of inflation and higher rates loomed.

Meanwhile, the Eastern financial elites that Patman and Gore scorned were an important political target for the Johnson administration. Robert E. Kittner, Johnson's Secretary of the Cabinet and former president of ABC and NBC, wrote in a July 1966 memo to Johnson that "the greatest damage the president did to the Republican Party between 1963 and now was to get business and banking support, including contributions—the former mainstay of the Republican Party, particularly in New York and Los Angeles."[32] Kittner suggested "an informal program to find out, confidentially, how important business, financial, and industrial leaders feel toward the job being done by the president." Embracing populist Democrats and campaigning against high interest rates would have sabotaged the Administration's effort to reach out to banking interests. Wall Street leaders recoiled at Patman and Gore's crusade to reign in the Fed's independence. They argued that rising rates were the natural product of market forces and any attempt to assert Congressional or White House control over the Fed would dangerously distort capital markets.

[31] Memo, Ackley to Johnson, Aug. 16, 1966, C.F. FI 8 1/15/65 - 12/3/65, Box 50, WHCF, LBJ Library.
[32] Memo, Kittner to Johnson, Jul. 6, 1966, "Business support for the President," C.F. BE 1966, Box 2, WHCF, LBJ Library.

As Sidney Homer, a partner at Salomon Brothers, remarked in a speech before financial executives in September 1967, economic populists like Patman and Gore "say the Fed has complete control over interest rates and that 'the free market is a fiction.' You gentlemen, of course, know that all this is nonsense."[33]

While Southern populists raged against the Fed and Wall Street, many Congressmen from the Northeast saw it differently. Republican Sen. Jacob Javits of New York, for example, argued that the Administration had done too little to fight inflation and that restrictive monetary policy and a tax increase were needed to curb inflationary pressures.[34] Ultimately, the Johnson Administration rebuffed the economic populists and effectively allied themselves with Northeastern monetary hawks (including many Republicans). The interest rate battles thus suggest an alternative story of regional party realignment, not around issues of race but rather issues of money. But if the administration was not going to fight higher interest rates, it would need to do something to alleviate their effects on the mortgage market.

The Free Market Program

The Johnson administration hoped that Raymond Lapin could help develop alternative methods of combating mortgage shortages. In the spring of 1967, Johnson appointed Lapin president of Fannie Mae. Lapin was a California mortgage banker, advisor to Gov. Brown, and "stalwart Democrat."[35] He received strong backing from the California Congressional delegation as well as the National Association of Home Builders (NAHB). Nathaniel Rogue wrote to the

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[33] Speech, Sidney Homer, Sep. 7, 1967, "The politics of Interest Rates in 1967 and 1968," given before the annual convention of the Savings Association League of New York State, 9/7/67, attachment to memo, Fowler to Johnson, Nov. 2, 1967, C.F. FI 8 8/9/67-2/3/68, Box 51, WHCF, LBJ Library.
[34] "Key lending rate increased to 6%" *New York Times*, Aug. 17, 1966.
[35] Memo, Semer to Johnson, Sep. 10, 1966, FI 5-4 Housing 11/18/65 - 10/31/66, Box 41, WHCF, LBJ Library.

administration that they considered Lapin "innovative" and someone who had "made his mark in the private enterprise system as a very successful businessman."[36]

He quickly set out to change the way Fannie Mae did business, promoting his proposals in the language of "private enterprise" and the "free market." His use of the term "free market" placed him in the vanguard of a changing political culture in Washington, DC—one that included both Republicans and Democrats. While postwar liberals (and conservatives) had long touted America's "free enterprise system," they did not yet talk consistently of a "free market." "Free enterprise" evoked the image of the entrepreneur and suggested policies that would empower small businessmen. Lapin, on the other hand, emphasized the power of the market itself—rather than its participants—to create opportunity and prosperity. His "free market" would need government support but also freedom from regulation.

Lapin often reiterated the Johnson administration's argument that government intervention in the home finance system was a necessity rather than a desired outcome. If private enterprise could accomplish the same objective of affordable homeownership for the working and middle classes, Fannie Mae would be redundant. But, he argued, private enterprise could not at the current moment achieve the same functions as Fannie Mae. At a hearing before a House Appropriations Subcommittee in March 1968, Lapin declared, "Our idea of success is when Fannie Mae buys no mortgages. If the private market took them all, we would call that success."[37] For the time being, however, Lapin asserted that the tight money situation in the

[36] Memo, Rogue to Jacobsen, Jan. 6, 1967, C.F. FG 170-6, Box 257, WHCF, LBJ Library.
[37] U.S. Congress, House of Representatives, Committee on Appropriations, Subcommittee on Independent Offices and Department of Housing and Urban Development, Hearings, *Independent Offices and Department of Housing and Urban Development Appropriations for 1969*, 90th Congress, 2nd Session, Mar. 20, 1968, 419.

housing market demanded Fannie Mae assistance. Going forward, he argued, the association would seek to achieve maximum involvement of the private sector.

One of Lapin's first actions was to change the way Fannie Mae bought mortgages by establishing an auction system that he termed the "free market program." Before, Fannie Mae had set prices that it was willing to pay for mortgages and had let the market determine the volume. The price that Fannie Mae paid to a financial institution for a mortgage was inversely related to the mortgage interest rate. So, if Fannie Mae cut its prices, it meant that it was only willing to buy mortgages with higher rates. Lapin argued that such a system inhibited Fannie Mae's ability to quickly respond to market fluctuations. The association conducted periodic market surveys before setting the price and had to anticipate the market's movements yet refrain from leading it.[38] Indeed, especially in a tightening market, Fannie Mae officials did not want to lead prices further downward (which would push mortgage interest rates higher). As a result, FNMA's prices often lagged behind the rest of the market, especially during quickly tightening periods.[39] Such was the case in 1966. After a recovery in early 1967, the mortgage market began to tighten again in the summer.

Because Fannie Mae's prices failed to keep pace with the rest of the market, it received a flood of offers and struggled to satisfy them. Fannie Mae "literally is being swamped with mortgage offerings," wrote Executive Vice-President H.M. Gilbert in June 1967.[40] Weekly offerings to Fannie Mae jumped from $39 million in early May 1967 to $408 million by mid-June. As mortgage sellers increasingly turned to Fannie Mae, officials at HUD and Fannie Mae

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[38] H.M. Gilbert to Weaver, Jun. 15, 1967, RG 207 - Records of HUD, Subject Correspondence Files - Robert C. Weaver, Box 247, FNMA Board Meetings 1967, National Archives II.
[39] Lapin to Weaver, Dec. 12, 1967, RG 207 - Records of HUD, Subject Correspondence Files - Robert C. Weaver,Box 247, FNMA Memoranda 1967, National Archives II.
[40] Gilbert to Wood, Jun. 20, 1967, RG 207 - Records of HUD, Subject Correspondence Files - Robert C. Weaver, Box 247, FNMA Memoranda 1967, National Archives II.

worried that they would face a repeat of the previous year. In that year, Fannie Mae was unable to directly control the volume of mortgages it purchased. Its resources were significantly strained and it turned to the unpopular $15,000 ceiling. Lapin wanted to avoid a ceiling at all cost but price reductions were not appealing either. "Whenever FNMA drops [its prices], other investors always drop accordingly," Lapin pointed out.[41] Lapin argued that "FNMA should [n]ever drop with the market as we enter a period of severe credit stringency." If the association was going to fulfill its goals of supporting and stabilizing the mortgage market, it would need more money when the market tightened.

Through the summer and fall of 1967, the mortgage market continued to tighten. Though Fannie Mae avoided ceilings, it did announce several major price reductions. On August 27th, the association cut its price for the second time that year, by one and a half points. In testimony before the Senate Banking and Currency Committee, Lapin argued that ceilings could have potentially devastating impacts on areas of the country where home prices were high. Noting that he may have been "a little biased here," Lapin specifically noted how the $15,000 limit virtually cut off California from Fannie Mae funds.[42] Under the new "free market program," Fannie Mae would instead set the maximum amount of money it would use to purchase mortgages each week and mortgage sellers would make competitive bids to Fannie Mae. Lapin argued that this would allow the association to better direct its funds to areas that needed it most.

The "free market program" went into effect May 6, 1968. Cloaked in the language of market impartiality, the program heavily favored booming Sun Belt cities. As the *Los Angeles*

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[41] Laoin to Weaver, Jul 21, 1967, RG 207 - Records of HUD, Subject Correspondence Files - Robert C. Weaver, Box 247, FNMA Memoranda 1967, National Archives II.
[42] *Nomination of Raymond H. Lapin: Hearings Before the Committee on Banking and Finance*, *U.S. Senate*, 90th Cong. 5 (Sep. 5, 1968).

Times noted, the program "would work particularly to the benefit of California and other population-boom areas."[43] Indeed, the program foreshadowed GSE policies in the coming decades that would further benefit fast-growing areas. Lapin's successors would also explain their actions in terms of fairness and the "free market" but they would have widely disparate effects.

Tax Increase

One way to fight the credit shortage in the mortgage market was to increase taxes and thus to dampen inflation and avoid an interest rate increase. In August 1967, the Johnson Administration proposed a 10 percent surcharge on corporate and individual income taxes. Lapin also supported a tax increase. Failing to do so, he said in a press release "threatens to bring this year's unimpressive housing recovery to an abrupt end."[44] There was no other adequate short-term solution to a tightening market. Indeed, the home finance and homebuilding industry was generally united in its support of a tax increase. Looking back on the campaign for a tax increase, Bernard A. Polek, president of the Illinois S&L League, called it "an unusual year in that probably for the first time in history, we the people business leaders, and economists generally called for a federal tax increase—in an election year, of all things."[45] Yet, public and Congressional resistance to a tax increase was insurmountable.[46]

When Congress failed to pass Johnson's tax increase, the Fed raised the discount rate on November 20, 1967, setting off worries that 1968 would be a repeat of 1966. In a speech to the annual NAHB convention—only two weeks after the Fed's action—John Heimann, vice-

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[43] "Fannie Mae's New System," *Los Angeles Times,* May 6, 1968.
[44] FNMA Press Release, Dec. 5, 1967, RG 207 - Records of HUD, Subject Correspondence Files - Robert C. Weaver, Box 247, FNMA Memoranda 1967, National Archives II.
[45] Bernard A. Polek, "Presidential Year Highlights," *Illinois Reporter* (Sep. 1968), 5.
[46] Collins, "The Economic Crisis of 1968."

president of the New York private equity firm E.M. Warburg Pincus and Co. and a consultant to Fannie Mae, blamed the Congress and the Administration for failing to pass tax increases and spending reductions. Fed chairman William Martin had warned Congress that if significant fiscal measures did not gain approval, the Fed would be forced to fight inflation through monetary policy. The failure of Congress and the White House to reach an agreement on fiscal measures was, in the eyes of Heimann, yet another example of "the political anchor that threatens again to drag housing down." "Housing is far too ingrained in our political superstructure," Heimann argued. The resulting policies were housing bills that contained grand goals but, in practice, were primarily "pork-barrel handouts" to influential Congressmen and inaction on more pressing demands like reaching a more balanced budget. Heimann also criticized Congress for not raising the interest ceiling on FHA loans. The deep discounts that occurred when interest rates were significantly higher than the FHA ceiling made it more expensive for homebuilders to build new homes. "The fact is," Heimann stated, "that classical economics simply doesn't work with housing—not as long as politics continue to play such an important role." But to loosen the grip of politics would take more than higher mortgage interest rate ceilings. "As long as the mortgage as a credit instrument remains inadequate to meet the rigors of today's money market, housing will receive the short end of the stick," Heimann said. "It is only by turning to the security form of investment instrument that the mortgage can effectively side-step the political sword of Damocles that continually hangs over housing and home finance markets."[47]

Impact of 1966 Mortgage Crisis

[47] Speech by John G. Heimann before the Annual Convention of the NAHB, Dec. 4, 1967, RG 207 - Records of HUD, Subject Correspondence Files - Robert C. Weaver, Box 247, FNMA Memoranda 1967, National Archives II.

Before the dust settled on the worst credit crunch of the postwar era, the Johnson administration was already considering a significant transformation of the nation's home finance system. The president's top economic advisors took the crisis as evidence that the system was out-of-date, particularly in the way that it separated mortgage financing from other financial sectors. James Deusenberry, a member of the CEA, thought the 1966 crisis highlighted the problems of the highly compartmentalized finance system. In a memo to Joseph Califano, President Johnson's top domestic aide, he suggested that the administration find ways to "increase competition" among financial institutions. "The experience over the past year," he wrote, "has brought out the disadvantage of excessive specialization by savings and loan associations in mortgage finance," and "the case for authorizing, and possibly providing inducements for, diversification of assets of savings and loan associations appears stronger now."[48]

Johnson's chief economic advisor, Gardner Ackley, agreed that there was too much specialization in the home finance industry and also suggested that new sources of home finance would need to be tapped. According to Ackley, even without tight money, S&Ls had fundamental problems. Their structure was outmoded, he said. They "grew up when banks were not interested in competing for time deposits."[49] Now, many of them were "small and inefficient." They needed to diversify, he said. Instead of solely relying on mortgages, they should be allowed to expand into consumer loans and corporate bonds. Furthermore, Ackley argued that the home finance industry needed to be better able to tap "central credit markets." Ackley proposed the formation of "mortgage bond corporations" which would sell bonds secured by a number of mortgages, as a way of "channel[ing] private funds from the securities markets into mortgages."

[48] Memo, Duesnberry to Califano, Oct. 21, 1966, C.F. FG 600/Task Force on Financial Institutions, Box 36, WHCF, LBJ Library.
[49] Memo, Ackley to Johnson, Nov. 29, 1966, C.F. FI 10/11/66 - 1/24/67, Box 2, WHCF, LBJ Library.

Seeking to avoid a repeat of the 1966 mortgage crisis, the Johnson Administration set out to develop plans for restructuring the home finance system. In August 1967, President Johnson created a Task Force on Mortgage Financing to explore the "serious problems involved in the present system of mortgage financing."[50] Most of the Task Force's recommendations would be realized in the 1968 HUD Act's sections on Fannie Mae and mortgage securitization. Gardner Ackley chaired the task force, which included representatives from HUD, the Treasury Department, the Bureau of the Budget (BOB), the Council of Economic Advisors (CEA), the Federal Reserve, and the FHLBB as well as Raymond Lapin of Fannie Mae.

The task force would look for ways to "strengthen the savings and loan industry"—the backbone of the New Deal Home Finance System. But, more importantly, it would look beyond the New Deal system in search of new sources of home finance. CEA member James S. Duesenberry laid out the agenda for the task force. Specifically, the task force was to explore how "general capital markets… pension funds and individual investors" could be drawn to mortgage investment. To achieve this goal, the two main questions that the task force was to address were, first, what was the most "effective use of federal agencies to channel funds from other capital markets into the mortgage markets," and, second, how "to make mortgages more liquid and technically more attractive to investors without mortgage departments."[51] In other words, the task force was to look beyond the institutions that had traditionally invested in mortgages, like commercial banks and thrift institutions. Opening investment to those without in-

[50] Memo, Califano to Ackley, Aug 8, 1967, F "Mortgage Financing: Task Force Reports," Box 24, WHCF, LBJ Library.
[51] Duesenberry to Members of the Task Force on Mortgage Financing, Sep. 11, 1967, RG 207 - Records of HUD, Subject Correspondence Files - Robert C. Weaver, Box 247, FNMA Memoranda 1967, National Archives II.

house mortgage specialists would broaden the potential pool of investors to include a wide variety of institutions, such as investment banks and pension funds.

Several of the task force members had already expressed a belief that the New Deal Home Finance System needed drastic reforms. Lapin was a clear advocate of change. In addition to him, CEA members Ackley and Dusenberry had laid out their arguments that the system was outdated in the aftermath of the 1966 crisis.[52] Both were eager to break down the industry's highly specialized structure and find ways of tapping securities markets. Sherman Maisel, the Fed's representative on the task force, had been a prominent researcher in the field of home finance during his time at Berkeley's Haas School of Business. While there, he had been instrumental in establishing a Center for Real Estate and Urban Economics. His research highlighted the sensitivity of the home finance industry to interest rate volatility and suggested that the home finance system would need to be dramatically altered if periodic downturns in the housing industry were to be avoided.[53] Maisel's knowledge of the home finance system was key to his appointment by Johnson to the Fed in 1965.

Given the task force's composition, it was no surprise that its final report outlined a plan to transform the home finance system. On October 31, the task force released its report.[54] It found that "the present structure of mortgage financing does not adequately serve the needs of the housing market."[55] In the coming decade, the task force said, demographic pressures would increase demand for housing. Baby Boomers would begin to form families and buy houses.

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[52] Memo, Ackley to Johnson, Nov. 29, 1966, C.F. FI 10/11/66 - 1/24/67, Box 2, WHCF, LBJ Library; Memo, Duesnberry to Califano, Oct. 21, 1966, C.F. FG 600/Task Force on Financial Institutions, Box 36, WHCF, LBJ Library.
[53] For example Sherman J. Maisel, "Some Relationships Between Assets and Liabilities of Thrift Institutions," *The Journal of Finance* 23:2 (May 1968), 367-378.
[54] Mortgage Financing Task Force Report (Oct. 31, 1967), Mortgage Financing, Task Force Reports, Box 24, WHCF, LBJ Library.
[55] Ibid., 1.

Urban renewal projects would displace thousands of families who would need to find a new place to live.

Mortgage financing was heavily dependent on savings accounts at S&Ls and savings banks, but these accounts were facing significant competition from higher-yielding investments offered by commercial banks. This problem, called "disintermediation," had been a cyclical problem of the postwar housing market that occurred whenever interest rates rose. The solution, the task force said, was to find new sources of funding for mortgages. The most attractive source, they argued, were the vast resources of pension funds and other institutional investment capital. By "developing new channels through which the mortgage market can more effectively compete for funds in the general capital market," these officials hoped to break the cyclical disintermediation that occurred in the postwar financial markets.[56]

These "new channels" meant developing new financial tools to make mortgage investment attractive to institutional investors with neither experience in nor specialized knowledge of the mortgage market. Managing a portfolio of individual mortgages and avoiding risky mortgages required knowledge of each mortgage loan (the financial stability of both the mortgagor and the local real estate market where the loan was taken out), something that would be too costly for the average institutional investor. Instead, the task force proposed the development of securities backed by pools of mortgages. In this system, the S&Ls, savings banks, and mortgage companies that originated mortgages would continue servicing them directly. But they would then sell portfolios of these mortgages to Fannie Mae. Fannie Mae would pool them together and sell shares in these pools to institutional investors. These investors

[56] Ibid., 1.

would receive the mortgage payments minus a service fee paid to the banks that originated mortgages and to Fannie Mae. Fannie Mae's role in this process was provisional. In order to create a mortgage-backed securities market, the task force understood that the government would have to lead the way but "the long-term aim would be to reduce direct participation of government as mush as feasible."[57] In the future, they hoped private institutions would be able to securitize mortgages without the help of Fannie Mae.

The development of these "new channels" would radically transform the New Deal home financing system, which relied on institutions, particularly S&Ls, that were strictly limited to home financing. The task force advocated easing these barriers. The mortgage-backed security (MBS) would not only link mortgages directly to securities markets by encouraging institutional investors to spread their capital beyond stocks and bonds and into the mortgage market. It also allowed the specialized home financing institutions of the New Deal era to diversify their portfolios by issuing consumer loans on goods like home appliances and automobiles. The task force also argued for the removal of regional barriers for the development of a national MBS market. Many states had usury laws that placed a ceiling on the interest rates that banks could charge on mortgages. "Though originally written for [the] protection" of homebuyers, these laws, the task force argued, now actually "discriminat[ed] against home buyers in restrictive states" by making mortgages less attractive to investors in the higher-interest-rate environment of the late 1960s.[58] The task force proposed a system where capital could move more freely between the mortgage market and the securities markets, between different types of financial institutions, and across different regions of the country.

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[57] Ibid., 1.
[58] Ibid., 18.

"Crisis of the Cities"

In February 1968, in a special message to Congress, President Lyndon Johnson declared that America faced a "crisis of the cities." He stated, "The cities that sprang up along the seaports, the river banks and the prairie crossroads of America were built and grew with pride and hope—until the early 20th century." For the past sixty years, Johnson said, central cities had been "decaying." The middle-class had been moving to the suburbs and those left behind were "trapped [in the city] by a wall of prejudice, denial, and lack of opportunity." "Urban blight" had spread like a disease. And "decay" and "blight" contributed to pollution, crime, lack of employment, and poor public services. Johnson's historical vision of long decline notwithstanding, his speech was in direct response to a more recent crisis—the massive wave of African American uprisings that had swept US cities during the 1960s: the riots of Watts, Detroit, Newark, just to name a few.[59]

Johnson vividly portrayed the effects of the "urban crisis." It created "ghetto youth with little education, no skills and limited opportunity." It left "citizens afraid to walk their streets at night." It meant "Negroes, Puerto Ricans and Mexican Americans [were] barred by prejudice from full participation in the city's life." It also denied homeownership to low-income urban residents. And this was especially troubling, because, as Johnson said, "owning a home can increase responsibility and stake out a man's place in his community. The man who owns a home has something to be proud of and good reason to protect and preserve it." Here, contemporary listeners would have understood that Johnson was speaking directly to the urban riots of the

[59] Lyndon B. Johnson, "Special Message to the Congress on Urban Problems: 'The Crisis of the Cities,'" Feb. 22, 1968, *Public Papers of the Presidents: Lyndon B. Johnson 1968-1969* (Washington, DC: Office of the Federal Register, National Archives and Records Service, General Services Administration, 1970), 253.

previous years. Without homeownership, Johnson implied, urban residents could not be counted on to be responsible, to protect and preserve their own communities.[60]

This was not a new argument. Johnson's comment about the responsibility that homeownership encouraged tapped into a discourse that was often much more explicit about the connection between the lack of homeownership and the urban riots. It drew on social-science discourses about poverty and race dating to Progressive Era concerns about a "slum mentality" and more recent ideas about a "Culture of Poverty" advanced by anthropologists such as Oscar Lewis and Assistant Secretary of Labor Daniel Patrick Moynihan.[61] Johnson was also intervening in an ongoing debate on Capitol Hill about the connection between homeownership and urban disorder. In the aftermath of the July 1967 riots, Democratic Senator Robert Byrd (West Virginia) said, "slums are developed by slummy people."[62]

The popular freshman Republican Senator from Illinois, Charles Percy, was not as blunt as Byrd, but he did believe the lack of homeownership among urban blacks had contributed to moral decay and a tendency towards violence. In 1967, Percy proposed legislation to encourage homeownership for the urban poor in direct response to the riots. His legislation called for the establishment of a "National Homeownership Foundation," which would lend money to local nonprofits for buying and rehabilitating homes. These nonprofits would then sell them to low-income urban residents with government-subsidized interest rates. According to Percy, it would "mobilize the resources of the "private sector to make homeownership—and the pride and self-esteem that come with it--available to lower-class families."[63] He brought numerous witnesses

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[60] Ibid.
[61] For example, Oscar Lewis, *Five Families: Mexican Case Studies in the Culture of Poverty* (New York: Basic Books, 1959); Daniel Patrick Moynihan, *The Negro Family: The Case for National Action* (Washington, DC: Office of Policy and Planning Research, United States Department of Labor, 1965).
[62] "Crisis," *Los Angeles Times*, Jul. 30, 1967.
[63] *Housing Legislation of 1967: Hearings Before the Subcommittee on Housing and Urban Affairs of the Committee on Banking and Currency, U.S. Senate*, 90th Cong. 193 (Jul. 19, 1967).

before the Senate Banking and Currency Committee to corroborate his viewpoint. A representative of Better Rochester Living of Rochester, NY, a nonprofit organization with roots in that city's mainline Protestant community, declared, "there is one factor that can dilute this rioting, and that is homeownership."[64] "With homeownership," he went on, "you have a person who has a vested interest in his equity." Milton Kotler, of the left-leaning think-tank the Institute for Policy Studies, stated that Percy's "homeownership program can help secure the community… [and its] turf."[65] Judge John Henry Norton of the Catholic-affiliated nonprofit organization Large Families Association, described the value of homeownership in broader terms: "The Indians had their own tepees… the Eskimo has had his own igloo," and "all bird and animal life like to exercise some dominion over some small portion of this world." He went on, "the sooner we understand that every man, no matter how humble, no matter what modest means he has, the sooner we understand that he, too, likes to exercise a little dominion over the world, then we will begin to understand the frustrations in these urban areas." Homeownership would stop the rioting, according to Norton, because "who in the world is going to be stupid enough to reduce his own property values where he has become an established resident himself?" Both Norton and Percy approvingly cited the work of anthropologist and playwright Robert Ardrey, whose book *The Territorial Imperative* (1966) argued that humans had an innate, biological drive to aggressively seek territorial domination—an instinct that could be traced back to humans' primate ancestors.[66]

Also speaking at the hearings was Nathan Wright Jr., Chairman of the National Conference on Black Power and leading advocate for black business empowerment, which would become

[64] Ibid. 958 (Jul. 27, 1967) (statement of Garson Meyer).
[65] Ibid, 1013.
[66] Ibid., 1020.

known as "black capitalism."[67] He flatly declared, "renters tend to be less responsible people than homeowners." "Black people in our urban ghettoes," he said, "are a renter class and thus the system tends to make them into irresponsible people." In Wright's conception of Black Power, black ownership of business and homes had the potential to transform black identity. Lack of ownership had created a "negative self-identity," characterized by "irresponsible," "self-destructive" tendencies that culminated in the "psychotic behavior" of rioters. Homeownership would help blacks achieve "self-confidence" and "self-respect" and make them more "responsible" citizens by giving them a "a sense of investment in the life of their communities and in the life of the Nation as a whole."[68]

Of course, the lack of quality housing for poor urban blacks was a key grievance of the protestors that filled the streets of American cities in the mid-60s. The uprisings targeted specific symbols of racial oppression, including white-owned property. But in the telling of Percy and his supporters, these protestors did not embody a political movement fueled by specific grievances; they were instead driven by raw emotions. Without the economic interest of home equity or the "pride" and "responsibility" of ownership, without the ability to fulfill their innate imperative for territorial dominion, African Americans' "frustration" could not be contained. Poor urban blacks would develop anger towards all who owned property and disrespect for "private property" in general—not merely the property of their oppressors.

Worries about the potential for insurrection by an urban tenant class and interpretations of urban uprisings as cases of indiscriminate, emotionally driven violence have a long history in American political discourse. During the second half of the nineteenth century, as large numbers of immigrants filled American cities, Progressive reformers argued that adequate housing was a

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[67] On "black capitalism" see Matthew Countryman, *Up South: Civil Rights and Black Power in Philadelphia* (Philadelphia: University of Pennsylvania Press, 2006).
[68] Ibid., 864.

moral imperative and a political necessity—an ill-housed urban underclass displayed little concern for its neighborhoods, contributed to blight, and provided a fertile ground for radical rebellion.[69] In 1950, the famous postwar suburban homebuilder William Levitt updated the idea for a Cold War world: “No man who owns his own house… can be a Communist.”[70] In introducing his legislation, Senator Percy embraced historical antecedents to his claim that homeownership could prevent urban riots. The Pilgrims, Thomas Jefferson, Abraham Lincoln, Walt Whitman, and Herbert Hoover, he said, all agreed that owning a home would produce a law-abiding, responsible, and less riot-prone citizenry.[71]

The Johnson Administration and congressional liberals criticized Percy’s plan for its use of nonprofits rather than government agencies and predicted that its subsidies would not find their way to the people who needed them most. Percy’s general ideas, however, received praise from Republicans and Democrats alike on Capitol Hill. Though disagreeing on policy specifics, Percy and the Johnson Administration would work together to formulate the Housing Act of 1968. One part of the act, Section 235, would realize Percy’s plan of government-subsidized mortgages for low-income homebuyers, but instead of nonprofits, the FHA would oversee Section 235 subsidies.[72]

In the “Crisis of the Cities,” Johnson laid out his plan to address “urban problems.” In addition to the more familiar “Great Society” programs, Johnson called for a ‘New Era in Home Financing.” In order to direct capital from “large pension funds” and “private trusts” into

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[69] For a history of Progressive Era reformers see Daniel T. Rodgers, *Atlantic Crossings: Social Politics in a Progressive Age*, New Ed (Belknap Press, 2000).
[70] Richard Lacayo, "Suburban Legend: William Levitt," *Time,* Jul. 3, 1950.
[71] *Housing Legislation of 1967: Hearings Before the Subcommittee on Housing and Urban Affairs of the Committee on Banking and Currency, U.S. Senate*, 90th Cong. 1517 (Appendix 2—Explanatory Statement Submitted by Senator Percy).
[72] Chapters 3 and 4 will discuss Section 235 in more detail.

mortgage financing, Johnson proposed the development of a "new, marketable financial investment, with competitive yields and security." This "bond-type obligation," Johnson said, would attract large institutional investors who wanted to "avoid the bookkeeping and paper work associated with hundreds of individual mortgages." By bringing a new source of funds into the mortgage market, Johnson argued, mortgages would become cheaper and more readily available. Cheaper mortgages would allow more Americans, including poor urban blacks, to achieve homeownership and thus it would help them become more "responsible" citizens.[73]

Johnson used the "crisis of the cities" to advance the mortgage-backed security, but the idea of such an instrument preceded the urban riots of the mid-1960s. The structural economic problems of inflation and interest rates and the lobbying of mortgage bankers were at the root of Johnson's plan to create mortgage-backed securities. The urban riots of the mid- and late-1960s had given Johnson the opportunity to sell his ambitious plan to a wider public.

The Campaign for the 1968 Housing Act

At the center of the President Johnson's campaign for the 1968 Housing Act was the idea that the nation needed to construct vast amounts of new housing in the coming decade—26.2 million new units, according to the administration, almost twice as much as had been constructed during the ten previous years (14.4 million units). To meet this goal, it would not be enough to expand traditional programs, according to HUD Secretary Robert Weaver: "We must create a new generation of housing programs."[74]

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[73] Lyndon B. Johnson, "Special Message to the Congress on Urban Problems: 'The Crisis of the Cities,'" Feb. 22, 1968, *Public Papers of the Presidents: Lyndon B. Johnson 1968-1969* (Washington, DC: Office of the Federal Register, National Archives and Records Service, General Services Administration, 1970), 253.

[74] Robert C. Weaver, "Technology and the City; Closing the Gap," *Illinois Reporter* (Dec. 1968), 12.

Lapin argued that mortgage securitization and the reorganization of Fannie Mae would allow the mortgage market to attract new funds. Before a House Appropriations Subcommittee in March 1968, Lapin stressed the importance of mortgage-backed securities for attracting institutional investment into the mortgage market, especially from pension funds, which Lapin noted had been "growing by billions and billions." Though rich in capital, these investors, Lapin argued, lacked the staff to assess the value of individual mortgages. "It's just too much redtape (sic)," Lapin said. "They only want to buy securities."[75] With mortgage-backed securities, these institutions could invest in mortgages without spending significant staff resources. "One financial stock analyst could handle a pension fund, but if he had to service a thousand mortgages…it would take a big organization," Rep. Charles R. Jonas (R-North Carolina) stated. Lapin responded: "That is correct. I think one could say that it is passé to set up a big mortgage investment department these days. The newer type of investor just does not want to do it."[76]

In hearings before the House Committee on Banking and Finance, Title VIII, the section of the bill that reorganized Fannie Mae and authorized mortgage-backed securities, received wide support from housing industry representatives. The National Association of Real Estate Boards (NAREB) "enthusiastically support[ed]" Title VIII.[77] The Mortgage Bankers Association (MBA) called the mortgage-baked security "an excellent idea." The MBA accepted the idea that for the new instrument to be "readily accepted by the investment community," a "government

[75] *Independent Offices and Department of Housing and Urban Development Appropriations for 1969: Hearings Before the Subcommittee on Independent Offices and Department of Housing and Urban Development of the Committee on Appropriations,* 90th Cong. 436 (Mar. 20, 1968) (statement of Raymond Lapin).
[76] Ibid.
[77] *Housing and Urban Development Legislation and Urban Insurance: Hearings Before the Subcommittee on Housing of the Committee on Banking and Currency, House of Representatives*, 90th Cong. 271 (Mar. 12, 1968) (statement of W. Parham Bridges, chairman, Subcommittee on Mortgage Finance, Realtors' Washington Committee, National Assoc. of Real Estate Boards).

agency with an established reputation such as FNMA" would have to "lead the way." The MBA hoped that "others would follow" and called for measures that would provide for competition "on an equal basis" between Fannie Mae and other private institutions, meaning primarily that other institutions receive similar tax exemptions as Fannie Mae.[78]

Allen Oakley Hunter, the Chairman of California's Commission on Housing and Community Development (and future Fannie Mae president) also expressed support for privatizing Fannie Mae, but he argued that the bill did not go far enough in guaranteeing "private sector…control" over the new association. Hunter was a former Republican representative from Fresno. Elected in 1950, he lost his second re-election bid in 1954. From 1960 to 1970, Hunter worked for the Rossmoor Corporation, a land development company that built a series of retirement communities under the name Leisure World that catered to retirees that wanted an "active lifestyle." In 1967, newly elected California Governor Ronald Reagan appointed Hunter as the Chairman of the state's Commission on Housing and Community Development. Representing the Reagan administration at the 1968 hearings, Hunter worried that there was "entirely too much control retained by the federal government over the new FNMA."[79] The government would maintain oversight of many of the new association's operations, including its rate of return to stockholders, its debt-to-capital ratio and "even…the matter of what kind of mortgages to purchase." Here, he almost certainly meant that the government would pressure Fannie Mae to buy more low-income mortgages than its private owners would want.[80]

[78] Ibid, 282 (Statement of Lon Worth Crow, first vice president, Mortgage Bankers Association of America).
[79] Ibid., 634 (Statement of Allen Oakley Hunter, chairman, Commission on Housing and Community Development, California).
[80] In 1970, President Nixon would appoint Hunter to the presidency of Fannie Mae, replacing Raymond Lapin. Under the Carter Administration, Hunter would come into conflict with HUD Secretary Patricia Harris over Fannie Mae's commitment to its federal charter, specifically its limited investment in low-income and urban areas.

The AFL-CIO also expressed support for mortgage-backed securities and the Act in general. Citing the Kerner Report and President Johnson's "Crisis of the Cities" speech, Andrew Biemiller, the AFL-CIO's Director of Legislation, stated before the House committee hearings, "We in America today are the inheritors of a legacy of neglect, decay and indifference that has been festering and spreading in our urban areas for nearly a century."[81] For decades, little quality low-income housing had been constructed, even as the Great Migration brought millions of black families to the city. Now, middle-and upper-income families were moving to the suburbs along with industry and tax revenue. The "crisis" demonstrated the need to construct at least 2.5 million new homes per year in the coming years, Biemiller said. Such an effort would require drastic government action including public housing, interest-rate assistance, and rent supplements. The new mortgage securities would also help, according to Biemiller. "We find considerable pleasure in the bill's new imaginative concept to bring more money into the mortgage market through a proposal for the issuance of mortgage bonds," Biemiller testified. The AFL-CIO had "for considerable time" supported measures to attract capital from institutional investors, particularly pension funds, to the mortgage market. The union, however, expressed "reservations" about privatizing the ownership of Fannie Mae's secondary mortgage market operations. With diminished government "influence" over Fannie Mae's operations, privatization, Biemiller argued, could lead to a less "socially motivated" Fannie Mae.[82]

[81] *Housing and Urban Development Legislation and Urban Insurance: Hearings Before the Subcommittee. on Housing of the Comm. on Banking and Currency, House of Representatives*, 90th Cong. 537 (Mar. 12, 1968) (Statement of Andrew Biemiller).
[82] Ibid., 545.

Conclusion

On August 1, 1968, President Johnson signed the Housing and Urban Development Act of 1968, a far-ranging piece of legislation that included rent supplement programs, low-income homeownership assistance, property insurance assistance, and urban renewal programs, to name a few. The provision that would prove to be most transformative in the decades to come, however, was the act's reorganization of Fannie Mae and the creation of mortgage-backed securities. CEA Chairman Arthur Okun expressed strong approval of the legislation passed by Congress. The administration, he said, largely got what it wanted in terms of the "structural modifications in the mortgage market," and the act should be "hailed as a major American accomplishment."[83]

In his remarks at the signing ceremony Johnson placed the legislation within a progressive history of government housing policy since the New Deal, from public housing to urban renewal to the Model Cities program. But he also proclaimed the legislation to be even more significant than these programs. It was the "Magna Carta to liberate our cities. With it we now have new means to win new rights for every American in every city and on every country road. That new right is the fundamental and the very precious American right to a roof over your head—a decent home." It was a right grounded in a feminized domestic sphere. Johnson imagined that he and the other men who crafted the 1968 act were acting to fulfill the desires of women: "I had it vividly impressed upon me more than 35 years ago that the thing every woman in this world wanted, the thing that was right at the top of her priority list, was a home. I think it

[83] Letter, Okun to Wilfred Rommel (Asst. Director for Legislative Reference, Bureau of the Budget), Jul. 30, 1968, P.L. 90-448 (I), Enrolled Legislation 8/1/68 HUD Act of 1968, Box 67, WHCF, LBJ Library.

is something every man and child ought to want—a home."[84] Women naturally knew what was best for their families—homeownership—whereas for men homeownership was a moral decision. Johnson thus posed his reorganization of the mortgage market as an enlightened act of masculine altruism.

The financial industry applauded the authorization of mortgage-backed securities. Lapin told a Senate hearing that he had met with representatives from the savings and loan industry as well as commercial, mortgage and investment banks, all of whom had expressed a "great deal of enthusiasm" for the new financial instrument.[85] The USSL "strongly endorsed" the new securities.[86] Mortgage bankers also approved. Mortgage securities, a 1968 article from *Mortgage Banker* claimed, would change the way mortgage bankers did business, allowing them to tap the vast resources of institutional investors.[87] The NAHB also expressed support and urged Fannie Mae and Ginnie Mae to make the new financial instrument "operative as quickly and as broadly as possible," specifically citing the need to tap the resources of institutional investors, particularly pension funds.[88]

Even before Johnson signed the Housing Act, his economic and housing advisors were advocating for maximum speed in implementing the mortgage securitization program.[89] Meanwhile, Lapin promised that the new Fannie Mae would "continue to serve the public

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[84] Lyndon B. Johnson: "Remarks Upon Signing the Housing and Urban Development Act of 1968.," August 1, 1968. Online by Gerhard Peters and John T. Woolley, *The American Presidency Project*. http://www.presidency.ucsb.edu/ws/?pid=29056.
[85] *Nomination of Raymond H. Lapin: Hearings Before the Committee on Banking and Finance*, *U.S. Senate*, 90th Congress 12 (Sep. 5, 1968).
[86] Ibid. 15 (Joint statement of United States Savings and Loan League and the National Association of Insured Savings Associations).
[87] *Mortgage Banker,* Sep. 1968.
[88] *Housing and Urban Development Legislation – 1969: Hearings Before the Subcommittee on Housing of the Committee on Banking and Finance, House of Representatives*, 91st Congress 146, (Jul. 17-30, 1969) (National Association of Home Builders, *NAHB Policy Statement for 1969*).
[89] Memo, Califano to Johnson, Jul. 25, 1968, C.F. FI 5-4 7/1/68, Box 42, WHCF, LBJ Library.

interest." "While FNMA must make a reasonable profit… it cannot and should not place its profit motive above its public purpose," Lapin told the Senate Committee on Banking and Currency at the confirmation hearings for his appointment as the head of the newly reorganized Fannie Mae.[90]

Even as Johnson heralded the act as a "Magna Carta" and his advisors urged the new Fannie Mae to begin securitizing mortgages as soon as possible, no one in his administration foresaw the extent to which the 1968 would lay the groundwork for a transformation in the home finance system. They could not imagine that the interest rate hikes of the 1960s would pale in comparison to those of the following decades. Nor could they imagine how inflation and the deregulation of New Deal interest rate controls would throw the thrift industry into crisis during the 1980s, ultimately ending its reign of dominance as the nation's prime source of mortgage funds. Later policymakers and financial executives would build on the policies created by the 1968 Housing Act. Securitization would be well positioned to take advantage of other changes in the home finance system in the decades to follow.

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[90] *Nomination of Raymond H. Lapin: Hearings Before the Committee on Banking and Finance*, *U.S. Senate*, 90th Cong. 2 (Sep. 5, 1968).

Part 2

Localism

Chapter 3

"A New Day": Financial Localism in Illinois

In the first edition of his classic textbook *Economics,* published in 1948, Paul Samuelson described the U.S.'s banking system in the following terms: "unlike England or Canada, where a few large banks with hundreds of branches are dominant, the United States has tended to rely upon many independent, relatively small, localized units."[1] In a footnote, Samuelson acknowledged the important exceptions of New York's Chase National Bank and California's Bank of America, each of which had numerous branches scattered across the city and state, respectively. While New York and California were home to major exceptions to the U.S.'s "tendency" towards small, local financial institutions, Illinois served as its paradigmatic example during the postwar era. State prohibitions against bank and S&L branching meant that each institution could operate only one office—from the small-town S&L to the largest Loop bank. It would not be until the 1970s for S&Ls and 1980s for banks that the state's regulations would permit branching. Over the past forty years, the U.S. financial system has changed dramatically from the one described by Samuelson in 1948. Perhaps nowhere was this transformation so dramatic as in Illinois.

[1] Paul A. Samuelson, *Economics: An Introductory Analysis* (1st ed. New York: McGraw-Hill, 1948), 311.

From the 1950s through the 1970s, Illinois financial institutions engaged in a heated intra-industry battle over branching. The majority of S&Ls and the Illinois Savings and Loan League (ISLL) supported branching restrictions. Most S&Ls, especially downstate associations and those already established in the Chicago suburbs, were more interested in protecting their turf than growing beyond it. For decades, they were able to successfully defeat the efforts of large Chicago financial institutions that sought to liberalize the state's strict prohibition against branching. The conflict over branching and industry consolidation in Illinois provides insight into the role of business interests within early postwar political culture and particularly their relationship with midcentury liberalism. It corroborates the work of historians such as Robert Collins and Wendy Wall, who have argued that postwar liberalism was far from anathema to business.[2] But it also argues against a continuity narrative of business' role in politics from the early postwar period into the 1970s and 1980s. Postwar liberalism and local business patriarchs were simpatico, at least in the case of finance. The break between the early postwar era and the 1970s and 1980s was not a turn to business per se but a turn to larger businesses and to industry consolidation. This transformation in business politics came despite the vociferous opposition of small-scale, local financial executives.

Illinois S&Ls largely embraced financial localism in rhetoric as well as policymaking.[3] S&L executives described their institutions in soaring rhetoric that emphasized their communal altruism rather than their business acumen. They promoted themselves as enlightened "caretakers of our communities' financial resources," encouraging the twin American values of thrift and

[2] Robert Collins, *The Business Response to Keynes, 1929-1964* (New York: Columbia University Press, 1981); Wendy Wall, *Inventing the 'American Way': The Politics of Consensus From the New Deal to the Civil Rights Movement* (New York: Oxford University Press, 2008).
[3] For a history of the S&L industry in the US and its embrace of localism see David Mason, *From Building and Loans to Bail-Outs: A History of the American Savings and Loan Industry, 1831-1995* (Cambridge: Cambridge University Press, 2004).

homeownership.[4] S&Ls were a "living union" that provided a "common bond" between financial executives and "the proverbial butchers, bakers, and candlestick makers of the community."[5] Another S&L employee described her institution through the metaphor of a human being: "For are these savings and loan associations not like a man—composed of certain vital parts all functioning harmoniously to one end—that of better serving mankind?"[6] Patriarchal communalism, rather than free-market competition, guided the S&L industry, according to its leaders.

In 1971, the FHLBB opened the door to limited S&L branching in Illinois. Other regulations soon followed, making it progressively easier for S&Ls to operate more than one office and, importantly, relocate their headquarters to the suburbs. The FHLBB's decision came despite widespread industry opposition in Illinois. But the FHLBB was concerned about the financial stability of S&Ls in racially transitioning areas and the potential loss to the federal government in the case of these institutions' failure.[7] Rising interest rates during the late 1960s had created new problems for the S&L industry and small, urban institutions were hit especially hard. Despite initial opposition, once the door was opened to branching, S&Ls were quick to take advantage. By 1981, 210 of the state's 350 S&Ls had at least one branch. The largest of them operated numerous branches. The sixteen S&Ls that had ten or more branches controlled $36 billion of the state's $100 billion in savings deposits.[8]

[4] Robert S. Buckett, "A Challenge; A Responsibility; An Opportunity," *Illinois Reporter* (Aug. 1969), 1.
[5] Thomas Gobby, "Faces," *Illinois Reporter* (Feb. 1969), 2.
[6] Sue Hall, "Anatomy of a Savings and Loan," *Illinois Reporter* (Feb. 1969), 2.
[7] "Door Here Opened to S&L Branches," *Chicago Tribune,* Mar. 13, 1971.
[8] FHLB, *Summary of Savings Accounts by Geographic Area,* (Washington, 1981), 9. All dollar amounts are in 2015 dollars unless otherwise noted.

Financial executives from the state's largest institutions argued that Illinois would have to liberalize its regulations in order to compete with other cities as a financial center. Meanwhile, a growing minority of S&L leaders argued for a new understanding of their industry. With a heavy dose of nostalgia for the past, they called on the industry to accept "new realities." Gone were the days when S&L executives could concern themselves only with local affairs. They would have to adapt to the growing interconnectedness and volatility of financial markets with "flexibility" and "innovation."[9]

Yet, the ethos of financial localism lived on. During the 1970s, several urban community groups, most notably National People's Action on Housing (NPAH) and the Citizens Action Program (CAP) would vigorously protest the erosion of financial localism and particularly the liberalization of branching regulations. They would connect branching to what they saw as a growing anti-urban bias in the financial industry. And they would rely on a rhetoric of financial localism that saw S&Ls as locally rooted institutions with special rights and responsibilities to the communities they served. The political power that this rhetoric enjoyed was thanks, in large part, to the image that the industry itself had cultivated over the previous decades.

[9] "The 70's A New Ballgame," *Illinois Reporter* (Oct. 1969), 1.

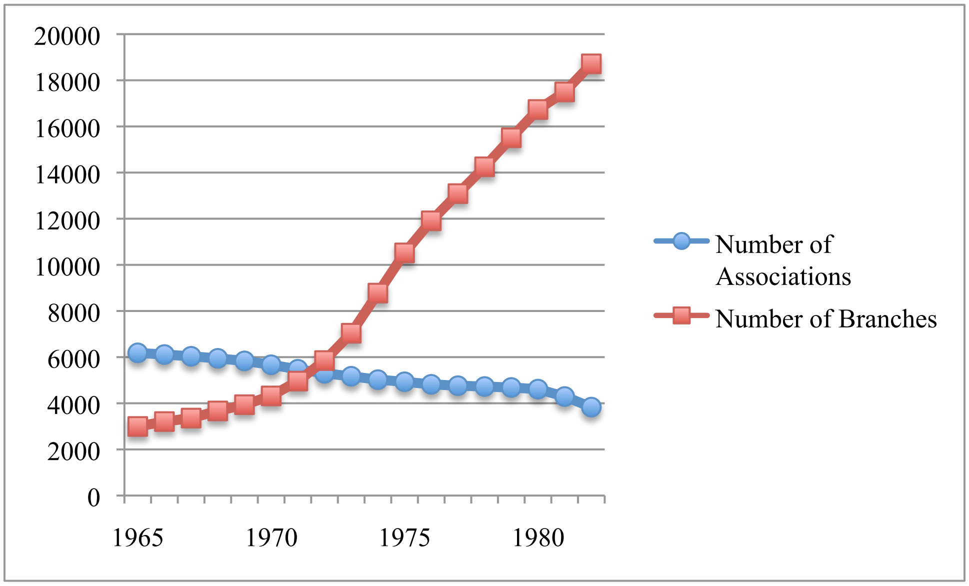

Figure 3.1. Number of S&Ls and S&L Branches in the United States, 1965-1982
Source: Franklin H. Ornstein, Savings Banking: An Industry in Change (Reston: Reston Publishing Company, 1985), 131.

Illinois S&Ls

While California was home to the nation's largest S&Ls—a cause and consequence of the region's rapid postwar growth—the Chicago area was home to more S&Ls than any other urban area in the nation (274 in 1963—more than forty-five of the fifty states).[10] In the Northeast, a wider diversity of financial institutions existed, including many more large commercial and mutual savings banks—a product of the region's legacy as the nation's financial center since the eighteenth century. Meanwhile, Chicago's incredible industrial growth from the late nineteenth to mid-twentieth centuries coincided with the growth of the nation's S&L industry. Moreover, until the early 1970s, Illinois banks and S&Ls, both state and federally chartered, were barred by the state from opening branch offices. This meant that the state was home to the largest number of individual financial institutions. Branching restrictions in Illinois were largely the result of

[10] "Aged Cook S&L Industry Has All the Vigor of Youth," *Tribune*, Dec. 29, 1963.

industry lobbying. A majority of the state's financial institutions opposed branching out of a desire to protect turf and avoid competition. Despite branching restrictions, Chicago was also home to several of the nation's largest S&Ls. In 1967, First Federal S&L was the largest in the city and the eleventh largest in the nation measured by assets ($4.4 billion). Talman Federal and Bell S&L also ranked in the top fifteen nationally.

Chicago S&Ls, like those in California, wrote their own histories of their communities and their industry. One such history, produced by the Cook County Council of Insured Savings Associations and reproduced in the pages of the *Tribune* in 1963, described Chicago's S&Ls as "an old industry that found the 'fountain of youth'" in the postwar period. Of course, in this history the "fountain of youth" was neither FHA insurance, nor FHLB subsidies, nor any of the other ways that government supported the industry during the postwar era. Instead, it was "one of America's greatest 'Horatio Alger' stories… a success story of not just one great rugged individualist but of an entire industry that rose to the top."[11]

Like S&Ls elsewhere, Illinois associations saw themselves as promoting something "greater" than merely the success of their own institutions or even the industry as a whole. As an executive vice-president of the Illinois S&L League declared in a special Christmas message in 1968, S&Ls, as "quasi-public institutions," sought out the "great objectives" of "housing America and rewarding thrift."[12] According to Harvey P. Cleven, secretary of the Cook County Council of Insured Savings Associations, S&Ls' "community roots" were among their "greatest attributes":

> Adhering to the traditions which have made them integral parts of their communities… savings and loan associations are not merely clearing houses thru which transactions pass en route to absentee headquarters. Quite the reverse, S&Ls and their personnel are a vital part of their community…Local control gives

[11] Ibid.
[12] Henry Goodsitt, "From the Editor," *Illinois Reporter* (Dec. 1968), 1.

> customers a warm feeling towards their financial institutions. They realize that the growth of the institution is linked directly with the growth of the community.[13]

In language that evoked a kind of patriarchal communalism, S&L executives advanced the idea that their institutions were unique and had a special role to play in the history of the nation and even "mankind." In an article in the *Illinois Reporter*, Robert Buckett, an S&L executive from Ashtabula, Ohio, expressed his views of the industry in grandiloquent terms. John Donne's poem "For Whom the Bell Tolls," with its famous line "No man is an island," served as an epigraph. The world's population was growing fast and as it did, Buckett said, so too did "human interdependence." "The bell of John Donne," Buckett exclaimed, "tolls for you and it tolls for me. I believe there is a particular urgency for us as savings and loan men to respond to its wailing peal for new human communities for mankind." The gendered language of Buckett's article expressed the mission of S&Ls in patriarchal terms. "Man, through his institutions of government, granted us our caretaker rights," Buckett said. As "caretakers of… our communities' financial resources," S&Ls were an important part of the "conglomerate we call the 'Community Builders," uniquely positioned to provide housing to the nation's families. The growing population and housing needs of the nation presented "a challenge, a responsibility, [and] opportunity," for S&Ls.[14]

The Illinois Savings and Loan League (ISLL) was the industry's primary lobbying group, dominated by small, independent S&Ls. For the ISLL, patriarchal communalism overlapped with its own interest in achieving organizational power and promoting the goals of the industry as a whole, rather than individual institutions. As its newsletter reminded readers, one of Cicero's

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[13] "Community Roots Attribute of S&L," *Chicago Tribune,* Jun. 29, 1965.
[14] Robert S. Buckett, "A Challenge; A Responsibility; An Opportunity," *Illinois Reporter* (Aug. 1969), 1.

"Six Mistakes of Man" was "the delusion that individual advancement is gained by crushing others."[15] Small, local S&Ls could best advance themselves through cooperation rather than competition.

Beginning in 1953, October was Savings and Loan month in Illinois. The ISLL organized a campaign to publicize the event and urged its members to get involved. It suggested that member associations advertise in local media and sponsor local high school essay-writing contests on the theme of "thrift." The league also instructed members to "hold open house—serve coffee…dress up the office and your employees in a particular theme [and] arrange exhibits of coins, currency, or items of unusual interest." "Do something newsworthy," the league said, "and be sure your paper gets the story."[16]

Gov. Shapiro declared the fifteenth Savings and Loan Month in October 1968 as part of the state's sesquicentennial celebrations. The official proclamation celebrated the state's 150-year history of "unparalleled growth and expansion from an infant prairie state to an economic giant… This heritage of greatness has been furthered by savings and loan associations founded locally throughout the state." S&Ls provided two-thirds of the state's home financing needs, allowing Illinois citizens to "reap the benefits of savings security, more jobs, more sales of building materials, home appliances and home furnishings, and the stabilizing effect on inflationary pressures provided by these community associations." "Without such financing," the proclamation stated, "many could not know the joy and pride of owning a home and becoming part of the community."[17]

[15] "Flaws Spotted 2,000 years ago still cause 'People Problems,'" *Illinois Reporter* (Aug. 1969), 4.
[16] "October is Savings and Loan Month," *Illinois Reporter* (Sep. 1967), 1.
[17] *Illinois Reporter* (Sep. 1968), 17.

The ISLL's publicity campaign also included an annual poster contest. The ISLL provided themes like "the more you save, the more you have" and cash prizes.[18] In addition to poster contests, the ISLL also sponsored annual speechwriting contests. Employees of the state's associations were invited to submit speeches that celebrated the industry's importance. Thomas Gabby, an appraiser for Talman Federal S&L of Chicago, won the 1969 contest with a speech called "Faces," which praised S&Ls as "a common bond" and a "living union" that brought together the many different "faces" of the community to work for both "individual… and community goals." There were the faces of "the savers" who "smile [with] satisfaction" as their "dreams…become realities through saving." Then there were the faces in the loan department, some a "bit anxious" as they take their first step towards homeownership. Others in the loan department were perhaps not so anxious, community leaders embarking upon plans for local improvements—"that group of men could be discussing a loan for the construction of a new school, church, or hospital." There were also the "faces" of "the president, the teller, the loan officer" and all the other employees, but it was the savers and borrowers that had "the most important faces… They are the proverbial butchers, bakers, and candlestick makers of the community."[19]

Sue Hall of Security S&L of Peoria, the runner-up in the 1969 speechwriting contest, began her speech with grand words: "Here stands before us a leader—a solid rock in the midst of the shifting sands—with a firm foundation and forward gaze—a bulwark never failing." Who was she describing? "These words might easily have been used in a political campaign, but of the same token, they might well be used to describe not a man, but an association—a savings and

[18] *Illinois Reporter* (Oct. 1969), 18.
[19] Thomas Gobby, "Faces," *Illinois Reporter* (Feb. 1969), 2.

loan association. For are these savings and loan associations not like a man—composed of certain vital parts all functioning harmoniously to one end—that of better serving mankind?" Hall went on to describe "the anatomy of a savings and loan." "The brain…the board of directors, the president and the officers…plan and direct the association's actions," just as a human brain "reasons and plans man's actions." The blood was "the employee-customer relation," which provided an "exchange of ideas…a lifeline between the association and its customers" and so forth.[20]

The ISLL urged its members to get involved in politics. "Politics is not a dirty word," the League's public affairs and legislative representative Harold Widmer told members. "It is the art of government." Widmer encouraged S&L executives to participate in electoral politics. But Widmer also stated, "doing one's part…does not necessarily mean becoming a rabid partisan." More subtle engagement—such as writing to congressional representatives, making sure friends and family voted, volunteering for a campaign, or holding a "coffee klatch"—constituted meaningful political engagement. Beyond electoral politics, civic engagement more generally offered opportunities for S&Ls to improve their community standing and influence politics from the local to the national. Library boards and school boards were places "your training, integrity and intelligence can be contributed to a solution of a community problem." "Through this involvement," Widmer said, S&L executives could "gain greater respect from political leaders of both parties" and "political understanding and support" that would help the industry achieve its objectives in Springfield and Washington.[21]

For S&L executives, "regulation" was often not a bad thing. Regulations were "generally for the protection of the consumer—our important savings customer," but they often worked for

[20] Sue Hall, "Anatomy of a Savings and Loan," *Illinois Reporter* (Feb. 1969), 2.
[21] Harold Widmer, "The Body Politic," *Illinois Reporter* (May 1966), 4.

the benefit of associations as well, according to ISSL First Vice Present Daniel J. Nicholas. Indeed, "regulation," rather than merely limiting the operations of associations, actually created new opportunities. "While regulations have evolved," Nicholas explained, "the leaders of our system and the leaders of our industry have worked long and hard trying to make new avenues of opportunity and profit for us." Thanks to their work, "new rules and regulations have been provided by legislation and regulators to make our business competitive." For example, Nicholas explained, "where would our business be today if regulations did not permit us to offer [savings certificates]?" The 1968 Housing Act was another example of positive regulation. The act permitted "new tools… to attract new money to the industry." Nicholas encouraged the industry to continue "develop[ing] new ideas and concepts for the Savings and Loan of tomorrow."[22]

Advertisements for S&Ls that were insured by the FSLIC often heavily emphasized their government backing—highlighting the public-private status of S&Ls. For example, a 1962 advertisement by the Insured Savings and Loan Associations of Cook County urged its readers to "Take more life out of living" by opening insured savings accounts at one of its member institutions. Too often, the ad stated, "worry—concern about your family's security—fogs over the richness of life." With an insured savings account, "you enjoy the greatest savings protection any institution can give—insured safety provided by a U.S. Government Agency."[23]

"A New Day" for the S&L Industry

By the late 1960s and early 1970s, inflation and disintermediation (the flow of funds from low-interest savings accounts to higher-interest certificates and securities) strained many financial

[22] Daniel J. Nicholas, "Management Needs For Change," *Illinois Reporter* (Mar./Apr. 1969), 1.
[23] Ad, *Chicago Tribune* (Dec. 30, 1962).

institutions and caused a shortage of mortgage money. This shortage of mortgage money was not shared equitably. Older, urban areas, especially African American, Latino and integrated communities (or neighborhoods nearby to such areas), suffered the most. In order to stay competitive with other investments, S&Ls paid higher interest rates on their accounts. In order to pay these higher rates, they searched for higher returns and less risky loans, which were often in the suburbs. Thus, the tight mortgage market added yet another draw to suburbia for financial institutions, both in terms of lending patterns and branching.[24]

The changing racial geography of the city was key in creating the conditions for upheaval in the state's financial system. As elsewhere, the federal government, the home finance industry, realtors and white homeowners denied access to mortgages for African Americans in Chicago and worked to segregate African Americans in overcrowded, poorly served urban neighborhoods. Even the growing black middle class, with more than adequate wealth, income and creditworthiness to afford homeownership, struggled to attain a home loan.[25]

Some in the housing industry sought out ways to capitalize on the increasing demand for homeownership among African Americans. During the 1960s and 1970s, these methods opened up new areas for black migration even as they stuck black homeowners with costly and risky home loans in neighborhoods suffering from massive disinvestment by financial institutions and city services.[26] In Chicago, most of these areas were white communities on the West and

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[24] "Greenlining Drive: Phase II," Box 2, "Greenlining- Mortgage Industry/Regulation 1973-1975," CAP Dubi, Chicago History Museum.
[25] Wiese, *Places of Their Own.*
[26] Beryl Satter, *Family Properties: Race, Real Estate and the Exploitation of Black Urban America* (New York: Metropolitan Books, 2009).

Southwest Sides. When neighborhoods became integrated, banks and S&Ls would most often refuse to originate conventional mortgages, which were not backed by the FHA or the VA.[27]

For S&L executives, "urban problems" were of great social importance, but they presented "opportunities" for associations. "Some may believe we have little to do with urban problems," ISSL vice-president Daniel J. Nicholas wrote in 1969. Yet, "a brief reflection," he said, "will indicate this is not so. We lend money throughout our whole community… Practical reasons of self interest require that we work toward solutions." There was no easy answer to the "urban problems" of "older areas…slums…rising crime rates [and] riots." There were "opportunities," however, for associations through "various programs presently available through government sponsorship," most likely referring to Section 235. Nicholas also encouraged associations to be "active in the community organizations," particularly "local self help projects."[28]

Many in the industry saw the 1966 mortgage crisis and its aftermath as a turning point. The 1966 crisis, wrote ISLL vice-president Daniel J. Nicholas in 1969, "brought a clear reality" to the interconnectedness between local, national and international markets. "We are no longer isolated in 'our town,'" wrote Nicholas. The important lesson of 1966 was that in the new era of "fast changing money markets," S&L executives had to "know and understand" not just their own local economy but also "the national and international picture." Executives had to adapt to

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[27] See, for example, Amanda I. Seligman, *Block By Block: Neighborhoods and Public Policy on Chicago's Westside* (Chicago: University of Chicago Press, 2005); Gregory D. Squires, ed., *From Redlining to Reinvestment: Community Responses to Urban Disinvestment* (Philadelphia: Temple University Press, 1992).
[28] Daniel J. Nicholas, "Management Needs For Change," *Illinois Reporter* (Mar./Apr. 1969), 1.

this new "reality," Nicholas wrote. "I'm not sure we should ever return to an isolated type of business."[29]

The economic and racial turbulence of the housing market during the 1960s troubled S&L executives. "The easy days are gone forever," an American Banker editor, James Hambleton, told the New York S&L League.[30] "When we dubbed [the decade] the 'Soaring 60's, little did we realize that the word 'soaring' had a different connotation than our brilliant prognosticators predicted," wrote the editor of the Illinois Reporter Henry Goodsitt in 1970, referring to the "soaring" interest rates of the decade. He continued, "It is enough to depress and discourage those of us who have made a fetish and a goal as the principal financiers of home financing."[31] "A lot of people would just as soon forget the decade that just ended," wrote Nicholas, president of the Illinois S&L League, in 1970. "We soared all right," he wrote, "soaring casualties and costs, soaring taxation and inflation, soaring social ills, soaring crime and racial strife; soaring conjestion [sic] in population and pollution." But, at least now, according to Nicholas, "we see our problems and the depth of them." Without adapting to the new financial landscape of higher interest rates, "savings and loans as we know them could end up as a kind of dinosaur in a few years."[32]

The growth of the consumer credit industry, particularly credit cards, also provided competitive pressure for the industry. In an article for the Illinois S&L League's *Illinois Reporter*, Michael Stevenson, executive vice-president of the Savings and Loan Foundation, wondered whether the growth of the credit industry would lead to a "saveless society." "It is reasonable to assume," Stevenson wrote, "that the philosophy underlying the importance of

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[29] Daniel J. Nicholas, "Management Needs For Change," *Illinois Reporter* (Mar./Apr. 1969), 1.
[30] James R. Hambleton, "Commercial Bank Competition With Associations Here to Stay," *Illinois Reporter* (May 1967), 1.
[31] Henry Goodsitt, "A New Day," *Illinois Reporter* (Apr. 1970), 3.
[32] Daniel J. Nicholas, "Your Guru," *Illinois Reporter* (Apr. 1970), 1.

saving will deteriorate as people are increasingly encouraged to borrow for more services." The growth of credit, he said, "is eliminating the necessity for the public to have liquidity."[33]

According to industry leaders, S&Ls faced another, perhaps more troubling obstacle: a working class culture in decline. Industry leaders claimed that the working class was increasingly imprudent in its financial affairs—failing to save and spending too much. "Thrift is no longer a virtue of the working class," ISLL president Daniel Nicholas wrote.[34] James Hambleton agreed that not enough Americans recognized the value of savings, noting that twenty-six million American families did not have a savings account of any kind. But Hambleton placed at least some of the blame with the industry itself. S&Ls increasingly "neglected" vast swaths of the middle and working classes. They were failing to live up to their founding principle of promoting thrift among the nation's workers. Some, like Hambleton, argued that the future of the industry depended on re-invigorating a culture of financial thrift within the working class. Central to this effort would be an aggressive public relations campaign touting the societal value of "thrift" in general and S&Ls in particular.[35] According to Stevenson, the industry needed to "educat[e]…the public on the virtues and values of thrift."[36] Others, like Nicholas, all but wrote off the working class, emphasizing instead the need to attract more money from wealthier savers by better competing with banks and securities markets. "The savers that are the backbone of our

[33] Michael G. Stevenson, "The Checkless…To the Cashless… To the Saveless Society," *Illinois Reporter* (Nov. 1967).
[34] Daniel J. Nicholas, "Your Guru," *Illinois Reporter* (Apr. 1970), 1.
[35] James R. Hambleton, "Commercial Bank Competition With Associations Here to Stay," *Illinois Reporter* (May 1967), 1.
[36] Michael G. Stevenson, "The Checkless…To the Cashless… To the Saveless Society," *Illinois Reporter* (Nov. 1967).

institutions are the ones that have money…These rate-conscious savers must be attracted to our institutions," Nicholas wrote.[37]

What to do about the declining virtues of the working class was part of a broader debate about how the industry needed to adapt to a changing economic landscape. The industry's boosters, both executives and regulators, characterized the crossroads that they faced as one of great opportunity, a characterization that belied the structural problems that S&Ls faced. Speaking to the ISLL in 1971, John Lanigan, Illinois' chief S&L regulator, touted the "new horizons" of an industry that would become more flexible in its structure, more diverse in its investments and less hampered by restrictive legislation, such as branching prohibitions.[38] Henry Goodsitt, editor of the *Illinois Reporter*, presented the choices facing the industry in stark terms: "IT IS A NEW DAY," Goodsitt wrote. "We are between the adjurations of those who say let's innovate, start fresh, and not be hampered by tradition…get out from under the binding of laws and operations which have characterized a somewhat single specialty shop [and] those… who want you to stick to your shoemaker's last and weather the storm."[39]

Perhaps the most important issue that separated these two groups was how to respond to higher interest rates. The traditionalists favored reliance on New Deal-type interest rate controls. Others, like Goodsitt, believed that in the new economic landscape interest rate ceilings were anachronistic. All in the S&L industry, Goodsitt wrote, "deplore[ed] the situation of high interest rates and yet we are in a vice whose roots stem from the inflationary characteristics of the economy." Selective credit controls would not solve the "basic problem" of inflation, Goodsitt

[37] Daniel J. Nicholas, "Your Guru," *Illinois Reporter* (Apr. 1970), 1.
[38] John Lanigan, "New Horizons for the Savings and Loan Industry," Sep 27, 1971, RG 195, Martin Correspondence 1971, "La," Box 48, NAII.
[39] Henry Goodsitt, "A New Day," *Illinois Reporter* (Apr. 1970), 3.

argued.[40] They could only provide temporary relief. S&Ls would have to adapt to a higher interest rate environment.

Industry leaders like Goodsitt believed instead that the industry's future depended on "innovation," "diversification," and "flexibility." Goodsitt argued, and Nicholas agreed, that perhaps the best solution to an era of higher interest rates would be the adoption of adjustable rate mortgages—mortgages with interest rates that fluctuated according to prevailing rates. He also endorsed plans to diversify S&L holdings. "By making some money in the side issues we will have more for home financing," Goodsitt wrote.[41] Hambleton and Nicholas agreed. In his first address as the Illinois S&L League President for 1970, Daniel J. Nicholas predicted that the 1970s would bring "a new ballgame" to the financial industry. The S&L industry was "no longer a simple business offering little variety… We should compliment [sic] our mortgage lending with the existing and new types of lending programs." "To survive in the seventies," Nicholas said, "associations must diversify… Credit innovation…will be the prime source of improved profitability in the seventies."[42]

One of the most important ways that S&Ls were beginning to diversify was through service corporations—business entities in which the S&Ls would hold a minor ownership that could invest in a variety of lending, such as commercial real estate. The opportunities that service corporations presented seemed endless. Speaking before the ISLL John Lanigan claimed that "the use of service corporations—while limited to a certain extent by law—are practically limited only by the scope of your imaginations." When he took office in 1970, Lanigan promptly issued new regulations on service corporations that "were created with a view to offering the

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[40] Ibid.
[41] Ibid.
[42] "The 70's A New Ballgame," *Illinois Reporter* (Oct. 1969), 1.

industry broad, new opportunities to service the public and to provide increased profit opportunities to the industry." According to Lanigan, this was the type of regulation that the industry needed: ones that created new opportunities rather than limiting them. The industry needed to seize the initiative when it came to regulatory issues and avoid restrictive legislation that emanated from outside the industry, most importantly from consumer dissatisfaction. The latter type of regulation, Lanigan warned, once enacted could be difficult to undo: "as you know, the government is sometimes like an old dog: once it gets hold of a bone, it might never let go."[43]

According to Hambleton, the *American Banker* editor, S&Ls would need to become more like commercial banking or at least move towards greater "flexibility" than the old reliance on borrowing short-term (savings accounts) and lending long-term (mortgages). Consumer finance, these industry leaders believed, could allow S&Ls to avoid their reliance on this short term/long term business model.[44]

Some also argued that the legally set lending area of one hundred miles from the association's home office would have to be changed. "The present restrictions," Nicholas wrote, "unnecessarily limit an association's activities in a time of local recession." "Much of the lending areas of Illinois associations are located in Lake Michigan, beyond state boundaries or in sparsely populated rural areas," Nicholas argued, referring to the concentration of the state's S&L assets in the Chicago area, where the Lake Michigan coastline and the Wisconsin and Indiana borders further constrained S&L lending areas.[45]

For Preston Martin, the FHLBB chairman, a critical component of "innovation" was branching. In an address to the FHLB of Indianapolis stockholders' meeting, reprinted in the

[43] John Lanigan, "New Horizons for the Savings and Loan Industry," Sep 27, 1971, RG 195, Martin Correspondence 1971, "La," Box 48, NAII.Lanigan, "New Horizons."
[44] Justin Hulman, "General Reflections," *Illinois Reporter* (Nov. 1966), 1.
[45] "The 70's A New Ballgame," *Illinois Reporter* (Oct. 1969), 1

Illinois Reporter, Martin complained that the Indianapolis board had only approved “two or three branches” in the previous year. “Frankly,” he said, “that’s not enough. We are a public service industry, and our ‘public’ is moving out of the old neighborhoods.” More branches, Martin claimed could better serve growing suburban areas and, at the same time, “Inner City neighborhoods where black people and others can be counseled into the mainstream of personal and family financial management.”[46]

Branching

Federal regulation prohibited full interstate banking until 1994. Although some states began to permit out-of-state banking beginning in the 1980s, state laws more often prohibited consolidation and branching. For most of its history, the U.S. had a less consolidated financial industry relative to Europe and Canada.[47] The U.S. financial system borrowed many of its institutional forms from Britain. Yet in Britain and other parts of the Anglo-American world, including Canada, financial power was more concentrated in part because of a history of stronger central governments. In the U.S., by contrast, state governments had more power in shaping the financial industry. Often state regulations favored many cooperative forms of financial institutions that had their roots in England, like Building and Loan Societies (later known as S&Ls) and mutual savings banks.

Historically, bankers themselves were the most effective opponents to branching in the U.S. with one interesting exception. Interstate banking, aside from the two national banks, was consistently prohibited but states had different rules regarding intrastate branching. Before the

[46] Preston martin, ‘Second Thoughts On the Service Corporation,” *Illinois Reporter* (Jun. 1970), 6.
[47] See for example, Charles W. Calomiris, *U.S. Bank Deregulation in Historical Perspective* (Cambridge, U.K.: Cambridge University Press, 2000).

Civil War, Southern states permitted branch banking, while most Northern states prohibited it. In the South, the financial system most importantly served the dominant sector of the economy—large, slave plantations. Plantations required large sums of money to finance their operations. Moreover, instead of land serving as the primary source of collateral, as it did in the north, slaves were the primary source of collateral in the South. This meant that banks, instead of being tied to a specific piece of land in a particular place, were invested in the commodity of slaves. These two factors contributed to the development of branch banking in the South. Through branching, rural slaveholders could more effectively tap into the larger pools of capital necessary to service a relatively geographically remote and capital-intensive industry.[48]

Meanwhile, in the North, capital-intensive industries and trade were more urbanized and far-flung rural communities were less lucrative for large banks. Instead, smaller financial institutions, often cooperative in nature, dominated the rural north and were capable of meeting the relatively small capital needs of rural economies.[49] Most customers of large northern banks, traders and industrialists, lived in large and mid-sized cities.

During the postwar era, unit banking meant that Illinois was home to the largest number of separate banks and S&Ls in the nation. The vast majority of these were relatively small in comparison to other populous and relatively urbanized states. Branching prohibitions did not mean these institutions were financially isolated, however. A small number of ownership groups controlled many separate banks. These banks shared directors and sometimes, even officers. By 1973, the Illinois Bankers Association (IBA) estimated that one hundred of these ownership groups controlled a third of the twelve hundred banks in the state.[50] Although federal law

[48] Calomiris, *U.S. Bank Deregulation*, 59-63.
[49] Naomi R. Lamoreaux, "Bank Mergers in Late-Nineteenth Century New England: The Contingent Nature of Structural Change," *Journal of Economic History* 51 (Sep. 1991), 537-58.
[50] Alvin Nagelberg, "Liberal Relocation Policy Led to S&L Branch OK," *Chicago Tribune*, Jan. 19, 1973.

prohibited these ownership groups from formally organizing as holding companies, the interconnections in bank ownership represented by these groups remained. "Chain banking," where multiple banks split large loans, also linked banks directly together.

Nonetheless, most of these institutions were more concerned with protecting their turf than growing beyond their current location. The exceptions were mostly large Loop S&Ls and banks interested in using their huge assets to grow beyond their offices' areas. Yet the smaller institutions opposed to branching vastly outnumbered these large institutions. Thus, both the ISSL and the IBA, the main industry lobbies, opposed branching throughout the era, despite the fact that the 1959 proposal would have only permitted branching in the Chicago area and later proposals only permitted branching within the home county of the bank.[51]

The drive for branching within the state's financial industry came most strongly from the large Loop banks rather than the large Loop S&Ls. The banks were larger, more diversified and more outward-looking than S&Ls. Many of their clients were large corporations, including those based outside of Chicago. Loop banks repeatedly pressed for branching legislation. Stymied by the IBA, these banks decided to form their own lobbying group, the Illinois Council for Branch Banking, in 1961. From the late 1950s through the 1970s, nearly every state legislative session included the introduction of bank branching legislation. Most often, these proposals did not make it out of committee. When they did, they were soundly defeated on the floor, illustrating the lobbying power of non-Loop banks.

[51] Leonard Wiener, "Seen as Inevitable: New Acceptance of Branch Banking," *Chicago Tribune*, Jan. 24, 1973.

Proponents of branching argued that Chicago's future as a "financial center" depended on the ability of the city's large banks to operate more than one facility.[52] Indeed, they argued, "the state's economic development and growth as a money market center had been retarded by the absence of branches."[53] Suburbanization, the *Tribune* reported, had adversely affected "inner city" banks and the large, Loop banks' "ability to compete with such financial centers as New York and California for corporate business." Chicago corporate executives echoed large banks in supporting branching. In April 1967, Edgar Peske, vice-president and treasurer of Illinois Bell Telephone, addressed the Chicago Association of Commerce on the topic of "Chicago's Position as a Financial Center:"

> On virtually every front, Chicago and Illinois are reaching out these days to take advantage of an almost limitless potential. Among the human, natural and organizational resources in which we can exhibit pride, perhaps few are less understood than our financial resources. To begin with, we live in an industrial world. And industry and money are inseparable partners. Our financial institutions provide much of the capital needed by business—the vital lubricant without which our industrial complex would come grinding to a halt… Chicago is already a great financial center—a producer, handler and user of this 'green petroleum.'[54]

At this time Chicago occupied a pre-eminent position in its commodities markets. The Chicago Board of Trade handled 85 percent of the world's corn, wheat, soybean and rye futures. The Chicago Mercantile Exchange was the world leader in agricultural commodities like eggs and pork bellies. But as a "supplier of funds" through bank credit, Chicago had fallen behind. Large, midwestern companies were increasingly going elsewhere for their banking needs leading to a "dollar flow" out of the city. One of the key reasons, according to Peske, was the way branching prohibitions "fragmented" the industry's assets. "If the city's potential as a financial center is to

[52] Leonard Wiener, "Bankers talk of peace," *Chicago Tribune*, Dec. 31, 1975.
[53] Leonard Wiener, "S&Ls May Be Stimulus for Branch Banks," *Chicago Tribune*, Dec. 19, 1971.
[54] Dollar Drain Hurts City, Peske Says," *Chicago Tribune*, Feb. 24, 1967

be developed," Peske said, this "dollar flow" would have to be reversed.[55] Illinois would need a more concentrated financial industry in order to attract corporate funds.

Peske's affirmation that "we live in an industrial world" notwithstanding, his speech suggested that many in the corporate community saw finance as the key to economic growth in coming years. Indeed, in yoking finance to industry, Peske sought to place this "less understood" sector on stronger ground vis-a-vis the much celebrated manufacturing sector. Perhaps the changes in the global economy drove this effort to "develop" the financial industry. In the late 1960s, the economies of Europe and Japan were growing. Meanwhile, decolonization, the green revolution, and ideas about the "modernization" of third-world economies suggested that the U.S. might soon have many competitors, especially in agriculture and low-skill industrial production—areas that had previously been dominated by the American Midwest and particularly Chicago. Marshaling financial resources perhaps offered the best opportunity to preserve America's and Chicago's industrial dominance and drive further economic growth. Even if American corporations moved industrial production overseas, a robust financial industry would ensure that they deposited their wealth in U.S. banks.

In opposition to the banking industry, the S&L industry was concerned with preserving turf rather than growing. But for many, this opposition was at least somewhat contingent upon the banks' inability to branch. Indeed, both industries nervously watched the status of branching legislation affecting the other's industry, wary of the competitive advantage that would accrue to the industry that first achieved permission to branch.

[55] Ibid.

There was also widespread opposition to branching among the public. When a proposal to permit branch banking came before in the Illinois General Assembly in 1961, the *Chicago Defender* editorial page was among those expressing opposition. "In short," the editorial said, "what is at stake is the survival of the neighborhood banks with their long years of cooperative, useful and helpful service to the community. These independent banking units, with roots deep in the commercial soil of the various localities, would one by one be swallowed up or completely eliminated by competitive pressures." The winners would be "the giant banks, with their interlocking financial structure." The editorial denied its argument was "sentimental." It was simple "logic" that:

> neighborhood banks are the backbone of community business. In many instances they have grown up with the community, have a personal interest in its development, sympathize with its multiple problems, and are often identified with crusades to improve social and economic conditions. But for their understanding of the local problems and readiness to serve, more than a score of the neighborhood business undertakings would collapse beyond the possibility of recovery. They make on the spot decisions based on their intimate knowledge of the business personalities in the community. A branch bank, in contrast, would be cold, impersonal and slow in its dealings with the neighborhood. All commercial papers and transactions would have to be approved by the officers of the central bank, 15 miles away. The chances are they would have neither personal nor immediate concern for the general welfare of the community. [56]

By 1963 the intra-industry dispute had become sour. According to the president of the National Association of Supervisors of State Banks it was an "unreal feud" between the big Chicago banks and the smaller rural and suburban banks—one that threatened to lead to "warfare benefitting the industry's real competitors, credit unions and savings and loan associations.[57]

The widespread opposition to branch banking continued despite Mayor Richard J. Daley's endorsement of and lobbying for a 1965 proposal that would have put the issue before the public in the form of a referendum. By then, Illinois was one of only three states (along with

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[56] "The Branch Banking Bill," *Chicago Defender*, Apr. 17, 1961.
[57] "Perils Told in Bank Rift on Branching," *Chicago Tribune*, Oct. 3, 1963.

West Virginia and Kansas) that strictly prohibited branch banking. Daley's support was essential in securing enough Democratic votes for a branch banking proposal to make it out of committee for the first time, but the bill was soundly defeated on the floor 118 to 47. Industry resistance was decisive: 845 of the state's 1,043 banks opposed branching.[58] Resistance also came from the S&L industry. Sensing that 1965 presented the first substantial challenge to the prohibition against bank branching, the ISSL argued vigorously against the proposal, warning that branching would decrease competition and ultimately lead to unemployment.[59]

As the debate on bank branching intensified, the S&L branching question loomed. John deLaittre, a member of the FHLBB, publicly announced his support for S&L branching in 1965. (Appointed to the FHLBB in 1962 by JFK, de Laittre was a Republican from Minnesota, former president of the Farmers and Mechanics Savings Bank (Minnesota) and president of the National Association of Mutual Savings Banks.) Speaking before the United States Savings and Loan League (USSL), deLaittre argued that the absence of branching had "prohibited growth of financially sound institutions." As a result, numerous individual associations had been organized in the Chicago area. "The lure of highly profitable stock investments," deLaittre said, "has brought undesirable characters and money into some state-chartered stock savings and loan." These "undesirable characters" were engaged in "speculative lending."[60]

Rejecting the argument that fighting bank branching was akin to supporting the "real competitors"—the savings and loan industry—B.H. Ryan, president of the State Bank of East Moline (one of the Quad Cities) lumped the branching campaigns of the "large banks and large savings and loan" together. They both "want branch banking only to control money and credit in

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[58] George Tagge, "Political Lookout," *Chicago Tribune*, May 5, 1965.
[59] "League Pushes Drive Against Branch Banking," *Chicago Tribune*, May 5, 1965.
[60] "No-Branching Law Hit for Curtailing S&Ls in Illinois," *Chicago Tribune*, Nov. 11, 1965.

Illinois," he said. Ryan also directly addressed deLaittre's endorsement of S&L branching. Citing deLaittre's assertion that the prohibition against branching had led to an increase in the number of individual S&Ls, Ryan, in this 1965 letter to the editor of the *Chicago Tribune*, appealed to a broader audience that was perhaps more receptive to the idea of easy entrance into the industry than the S&L executives that had gathered to hear DeLaitre's speech: "I ask you, is this bad?" In the case of speculative lending, Ryan wondered, "where are the supervising authorities?"[61]

In the end, it was the federal government that opened the door to branching in Illinois. On March 12, 1971, without any hearings on the subject or even advance notice, the FHLBB broke with precedent to permit federally chartered S&Ls in Illinois to establish branches despite the fact that state regulations prohibited state chartered S&Ls from branching. Previously, the FHLBB had deferred to state branching regulations, allowing branching only where state regulations also permitted state chartered associations to branch. According to the FHLBB, the decision was prompted by concern for associations in weak financial status. Federal regulators blamed the state's unit banking system for creating the conditions for a disproportionate number of failures in Illinois. Of the $700 million of total losses to FSLIC from 1934 to 1971, $460 million had been incurred by Illinois institutions.[62] The inability of well-run and well-capitalized institutions to branch opened the door to less sound, riskier activities, according to the FHLBB. In cases where regulators determined that a supervisory merger was required to avoid failure, the fact that the troubled institution's office would need to be shut down presented an obstacle to achieving a negotiated merger.

[61] Letter to the editor, B.H. Ryan, "Branch Banking," *Chicago Tribune,* Nov. 17, 1965.
[62] "Door Here Opened to S&L Branches," *Chicago Tribune,* Mar. 13, 1971.

According to the FHLBB, many of the S&Ls in financial trouble were "trapped in deteriorating areas." S&Ls were "reluctant" to simply apply for relocation because they would then have to shut down their old office and lose their current accountholders. The new regulations would create a special exception for institutions in such "inner city areas." They would be able relocate their headquarters to the suburbs while maintaining their current location as a branch. The new regulations also allowed S&Ls that were in financial crisis, many of which were in the same neighborhoods classified by regulators as "deteriorating inner-city" areas, to merge with more financially sound S&Ls, often in the suburbs, and keep a branch at its old location.[63]

State regulators and industry organizations, including the ISLL and the Cook County Council of Insured Savings Associations, were highly critical of the FHLBB decision.[64] But in fact, state regulators had been studying similar regulations. The FHLBB forced the state's hand, and by April of that year state legislators introduced a bill to permit the same type of branching that the FHLBB now permitted. The new state regulations, allowed S&Ls in "deteriorating inner-city" areas to relocate their headquarters to "a more profitable neighborhood or suburb" and keep a branch in their original communities.[65] John Lanigan, the state Commissioner of Savings and Loan Associations, declared that December 10, 1971, the day the new regulations would take effect, would be "an historic day for Illinois." The change, he said, "would provide a tremendous boost to the industry," allowing "marginal institutions with little or no future to become part of larger institutions."[66] State officials sought to portray the branches as a compromise between the

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[63] Ibid.
[64] Alvin Nagelberg, "Urged to Hold Up Branching of S&Ls," *Chicago Tribune*, Mar 17, 1971.
[65] Alvin Nagelberg, "Illinois-Chartered S&Ls to Be Allowed to Form 'Branches,'" *Chicago Tribune*, Nov. 27, 1971.
[66] Ibid.

needs of urban communities and the potential for suburban growth. As Lanigan argued, branches "could stem the exodus from the city neighborhoods to the suburbs. It means there always could be some financial institution to provide direct services to the neighborhood."[67] But importantly, the city branches, technically called "facility offices," could serve savings accounts but could not originate mortgages. Customers had to go to the suburban headquarters to take out a mortgage.

S&Ls were quick to take advantage of the new opportunities and stake out suburban territory. By December, three federal S&Ls in Chicago had applied for a branch. With state regulations permitting branching going into effect December 10, industry executives expected there would soon be numerous applications to branch. Many associations had "mapped out their choices of relocation long ago in case branching was permitted," the *Tribune* reported. Now, the race was on to "grab the fastest suburban areas" before other institutions could.[68] By June 1973, CAP activists determined that 40 percent of the Chicago associations had already opened suburban offices or had declared their intentions to do so.[69]

Under the new regulations that allowed S&Ls to operate more than one office, associations still faced obstacles to opening a branch. The regulatory approval process afforded various opponents, both competing financial institutions and community groups, an opportunity to air grievances and convince regulators that the association's request did not fulfill the criteria needed to approve a branch office. Furthermore, under the new regulations, S&Ls were required to disclose lending data, giving evidence to community groups' claims that the S&Ls were already sending local money to the suburbs or to more affluent urban areas, namely the Loop and the lakefront area.

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[67] Ibid.
[68] Alvin Nagelberg, "Work to Clear S&L Facilities," *Chicago Tribune*, Dec. 15, 1971.
[69] "Savings and loans desert city," *CAP Action*, Jun. 1973, Box 6, "CAP Action Newsletter April 1971 - Winter 1975," Box 6, CAP - Booth, Chicago History Museum.

Permitting S&Ls to branch effectively opened the door to the growth of multi-sited financial institutions in Illinois, and it triggered intense political conflicts over the spatial politics of financial networks. By May 1973, state regulators had approved applications from eleven Chicago S&Ls to move their headquarters to the suburbs and maintain their current office as a "service facility." Meanwhile, twelve more state-chartered associations and thirty-one federally chartered associations were seeking approval for suburban offices. Successive reforms through the 1970s made it progressively easier for Chicago S&Ls and banks to operate an increasing number of branches. In January 1973, the FHLBB further expanded branching in Illinois, allowing S&Ls to open one branch (in addition to a service facility) within one hundred miles of their home office as long as they demonstrated the need for financial services at the proposed location, reasonable chances of success and that there would be no "undue injury" to existing S&Ls in the area.[70] Perhaps even more important, the FHLBB also placed no limits on the number of branch facilities a single S&L could maintain through mergers. The FHLBB claimed that its decision was only bringing regulation more in line with already existing financial realities: interlocking ownership and chain banking arrangements were tantamount to branching.[71]

Initially, Commissioner John Lanigan was highly critical of the liberalization of branching rules, calling the FHLB's decision "irresponsible."[72] But only three days later, at the announcement of state regulations that mirrored those of the FHLB, Lanigan expressed unhesitant support for the new branching plans. Lanigan cited the need for all three major constituents of the financial industry in the state (state S&Ls, federal S&Ls, and banks) to have

[70] Alvin Nagelberg, "Skokie S-L Files Branching Suit," *Chicago Tribune,* Oct. 19, 1973.
[71] Alvin Nagelberg, "Liberal Relocation Policy Led to S&L Branch OK," *Chicago Tribune*, Jan. 19, 1973.
[72] Alvin Nagelberg, "U.S. Home Loan Board to permit S&L branching," *Chicago Tribune*, Jan. 18, 1973.

the same branching capabilities. At the time, the IBA was reconsidering branching and Lanigan worried that banks would outpace S&Ls in branching changes.[73]

Regulatory approval of S&L branches also reignited the debate within the state's banking industry over their own branching prohibition. After encountering fierce resistance from small banks throughout the 1960s, large, Chicago-area banks had decided to move branching down their list of priorities in 1970. The competitive edge that S&Ls gained through the new branching powers, however, galvanized proponents of branch banking and convinced some bankers who previously were opposed to or unsure of branching, including many executives at small and moderate-size Chicago-area banks (those who would be most affected by the new branching rules), to support new rules that would allow banks to operate similar facilities. The *Tribune* reported that there was a "new acceptance of branch banking" within the industry: "it's not that the bankers previously opposed to branching have become converts to multiple-unit banking, but rather, many of them say, it's a case of being pressured … by external events," namely the liberalization of S&L branching regulations.[74]

In December 1972, the Illinois Bankers Association (IBA) committee on branching recommended support for limited bank branching. IBA President (also president of the First Bank of Oak Park) John F. McKnight reiterated the IBA's "basic philosophy" of supporting branch prohibitions but acknowledged that the group had to "be flexible and farsighted regarding the banking structure in Illinois." Suburbanization had created a mismatch between banking locations and growth areas, with "many populous areas without local banking facilities and depressed areas … with banks which do not have the resources necessary for rehabilitation."[75]

[73] Alvin Nagelberg, "State S&L branching bill sought by Lanigan," *Chicago Tribune*, Jan. 20, 1973.
[74] Leonard Wiener, "New acceptance of branch banking," *Chicago Tribune*, Jan. 24, 1973.
[75] Leonard Wiener, "I.B.A. Committee Backs Limited Branch Banking," *Chicago Tribune*, Dec. 15, 1972.

Smaller banks, however, still dominated the ranks of the IBA and held considerable sway with state lawmakers. In a letter to the *Tribune* editor, Thomas F. Bolger, executive vice-president of McHenry State Bank (about sixty miles northwest of Chicago) argued that it was in the "public interest" to maintain branching prohibitions. Even limited branching "inexorably leads to the concentration of money and power into a handful of giant banking systems in the metropolitan centers." Bolger went on to explain the benefits of the present unit banking system in Illinois:

> The unit bank is a part of the community, and obviously is more interested in developing the community than absentee-owned banking systems. The management of these systems prefers to make large loans to national businesses in urban centers and take care of large borrowers from out-of-state rather than negotiate several smaller loans in the communities where the subsidiary banks are located. This causes a shift of deposits away from the local community and into urban centers or even out-of-state… Banks do not create wealth. They are merely the vehicles for the orderly flow of capital. It is the economic growth of the area—not the type of banking system—which governs the amount of money deposited in checking accounts. Let us therefore maintain the system having the greatest and most direct stake in community prosperity—a system made up of independent, unit banks.[76]

Despite the recommendations of the IBA committee on branching, these banks defeated the proposal for limited branching by a two-to-one margin, closer than in the past but far from enough to mobilize the association's vast lobbying resources in Springfield. Once again branch banking was defeated in the legislature. Proponents of branch banking formed a new group, the Association for Modern Banking in Illinois (AMBI). Importantly, the AMBI rejected the "one-bank, one-vote" rule of the IBA for its decision-making, instead giving larger banks a more powerful voice through its board of directors, which set the organization's policy. And in June

[76] Thomas Fl Bolger, "Against Branch Banking," *Chicago Tribune*, Feb. 5, 1973.

1973, six of Chicago's large banks decided to withhold dues to the IBA and threatened to leave the group entirely in protest of the organization's opposition to branching. Branching supporters claimed their banks held eighty-five percent of the state's banking assets and complained that the IBA's "one-bank, one-vote" unfairly privileged small banks. In October 1973, James E. Smith, the state comptroller of the currency, added his influential voice to those supporting branching. "Branch banking is an essential element of modern, progressive, full-service banking, " Smith told the American Bankers Convention. Interstate branching, Smith also said, "deserve[d] consideration" as well as granting permission to foreign banks for domestic branches.[77]

Branch opponents responded by forming their own group, Bankers Against Monopoly (BAM). But the growing momentum for both bank and S&L branching proved insurmountable. When the FHLB decided to permit S&L branching, it set off a wave of branching liberalization that culminated in the removal of all intra-state bank branching regulations in 1981. In the decades that followed, the memory of unit banking in Illinois would fade quickly. By 1994, when Congress overturned all inter-state branching prohibitions, Illinois' financial industry looked like most other states.

Section 235

The liberalization of branching regulations coincided with the advent of a new form of federally-subsidized mortgage lending ostensibly directed to low-income families, the "Section 235" program. While FHA insurance and FHLB funding, among other subsidies, supported mortgage lending to middle-class whites during the early postwar era, public housing constituted the prime method for subsidizing poor and non-white housing. From its beginnings in the New Deal, government funding of public housing was minuscule compared to mortgage subsidization.

[77] Leonard Wiener, "U.S. official backs branching," *Chicago Tribune*, Oct. 10, 1973.

Nonetheless, conservatives, the housing industry and a broad section of the general public considered public housing projects to be a significant step towards communism and throughout the early postwar era, public housing was buffeted by successive waves of funding cuts. By the late 1960s, public housing increasingly came under attack by liberals and conservatives alike for encouraging a "culture of poverty" among its residents, many of whom were poor, African-American, female-headed families. This "culture of poverty," policymakers claimed, fueled the "crisis of the cities"—crime, intergenerational poverty and riots among urban African Americans.[78]

In this context, the Johnson Administration and Congressional liberals designed Section 235 to replace public housing and encourage the formation of male-breadwinner, nuclear families. Section 235 created a new form of mortgage lending.[79] Not only would the FHA provide insurance to lenders who financed low-income mortgages; HUD would also directly subsidize low-income borrowers' mortgage interest payments. Moreover, Ginnie Mae and Fannie Mae would purchase these mortgages from the private lenders that originated and serviced them. The government corporations would then securitize them. Thus, multiple layers of government insurance and subsidies protected both the private lenders and the purchasers of mortgage securities from loss, guaranteed them substantial profits and released them from the risk of a decline in neighborhood home values and foreclosure. Section 235 was thus conducive to massive lender abuse and blockbusting.

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[78] For example, Daniel Patrick Moynihan, *The Negro Family: The Case for National Action* (Washington, DC: Office of Policy and Planning Research, United States Department of Labor, 1965).

[79] On Section 235, see Andrew Highsmith, "Prelude to the Subprime Crash," *Journal of Policy History* 24:4 (2012), 572-611; Keven Fox Gotham, "Separate and Unequal: The Housing Act of 1968 and the Section 235 Program," *Sociological Forum* 15:1 (2000), 13-37.

Conclusion

During the early 1970s, the effects of Section 235 combined with the liberalization of branching rules sparked the beginnings of a grassroots homeowner movement. The disclosure of lending data required as part of branch applications clearly showed that Chicago S&Ls were funneling money from their home neighborhoods to the suburbs. Some S&L executives, the *Wall Street Journal* reported in 1974, "tacitly admitted" that many urban neighborhoods were cut off from mortgage funds while suburbs enjoyed easy access to loans. But they contended that in order to meet rising interest rates, they had to look to the areas where they could get the largest and safest return.[80] The general counsel and vice president of the Chicago Home Loan Bank Board, Ablion Fenderson, put it bluntly: S&Ls were sending their money to the suburbs because "that's where the action is."[81] An executive from Uptown Federal S&L defended his institution's practices as merely sound business: "if [an S&L executive] has a chance of investing in an area everyone sees as desirable and one he can see is deteriorating, what does he do?"[82]

For example, in 1973, Fairfield S&L, located in Wicker Park on the northwest side of Chicago disclosed lending data as part of its application to relocate to the neighborhood of Norridge, located in the far northwestern corner of the city. While the S&L held $249 million in savings from local residents in 1971 (53.1 percent of its total deposits), its loans in the area only totaled $11.6 million, only 2.3 percent of its home loans. Its community was an example of "the hard reality of plain speaking people settling a city. Logan Square. West Town. Names as Monopoly-board tough as Chicago… A Milwaukee Avenue bus at dusk is a rich blend of sights and sounds. Cleaning ladies home from the Loop step off; street dudes headed out on the town climb aboard. Polish dialects mingle with Spanish accents. And when the passenger steps off at

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[80] Terry, P. Brown, "Playing it safe," *Wall Street Journal*, Apri. 5, 1974.
[81] William E. Farrell, "Small-Homeowners Press Chicago Banks," *New York Times*, May 3, 1975.
[82] Ibid.

the vital center—the six-spoked intersection of Damen, North and Milwaukee, his eyes turn to the angular wedge-shaped headquarters of Fairfield Savings and Loan Association." The building had been a local landmark since its construction in 1901, according to the Sun-Times. It served as a symbol of urban progress of "an area once a prairie suburb and now an urban center." Now, although the association advertised that it "help[ed] Chicago families finance one of their most precious possessions—a home of their own," it was simultaneously planning to move its headquarters ten miles to the northwest and had "effectively written off its old location as a sound investment for conventional loans." The association's president, George M. Briody Jr. explained that Fairfield's present location was "changing to an area typical of inner city areas which cannot generate sustained savings capital." It was "frought [sic] with urban decay… empty stores, vacant and abandoned buildings, increasing crime rates and residents with little or modest, if any, ability to save." Community groups disagreed, instead expressing optimism about the area. "An influx of young 'rehabbers'" along with rising property values in neighborhoods closer in to the Loop provided reasons to be optimistic. "At least two real estate men who played prominent roles in the restoration of Lincoln Park 15 years ago, one a realtor and the other a mortgage banker, strongly disagree with Briody's assessment. They characterize the Wicker Park area immediately around Fairfield as the 'next Lincoln Park'."[83]

Predictions that Wicker Park would be the next Lincoln Park turned out to be accurate. But they were about twenty years too early. By the late 1990s, the area was home to a critical mass of gentrifiers that made it one of the hottest destinations for young hipsters in the city. The area around Six Corners became a mecca for a diverse range of upscale clothing shops, ethnic

[83] Scott Jacobs, "Is N.W. Side loan blood being cut off by S&L?" *Chicago Sun-Times*, Apr. 29, 1974.

restaurants, and popular nightclubs. In 2012, the old Fairfield building, which still towered over the intersection, got a new tenant—Walgreens Pharmacy. The new store kept much of the original decor: the granite floors, the ornate ceiling with its giant skylight, and the imposing bank vault, which now became a “vitamin vault.” The store sold all the typical items of a pharmacy: medicine, beauty products and grocery items. But it also had frozen yogurt machines, a sushi bar, a pannini counter, and an area dedicated to yoga supplies. Six Corners did not have an S&L anymore but less than a block away one could find a Bank of America office. Much less prominent than the Fairfield building, the Bank of America was tucked away in a row of cheap eateries and convenience stores, across the street from a Dunkin’ Donuts.

The new cityscape of Six Corners suggests how much the financial industry has changed over the past forty years. Fairfield’s central location and its imposing building symbolized its economic power within the community. The building was its headquarters, its only office. All of its $249 million in deposits were housed there. In contrast, the Bank of America office at Six Corners is one of five thousand branches operated by the company. Bank of America held about $1.2 trillion in deposits by 2015. It would take almost five thousand Fairfields to equal one Bank of America. Bank of America’s office symbolizes economic power on an entirely different scale. While the location itself is nothing special, the company does not need to rely on buildings to communicate its power. Instead, like Dunkin’ Donuts, it has become an international brand. Its shiny ATMs and slick teller windows, under the banner of an internationally recognized name, promise the ability for locals to fulfill all of their financial needs and participate in world capitalism.

Chapter 4

"The People's Money"

> Over the past turbulent decade the American society has been subjected to unusual stresses and strains. These include an unpopular war, double-digit inflation, Watergate, racial tensions, growing dissatisfaction with the failure of the 'system' to function as effectively as in the past, and a growing questioning of government at all levels and of the performance of major institutions, including the business system. A new militancy over the resolution of economic and social issues has been created. Encouraged perhaps by the growing importance of television, groups of all kinds and sizes stage demonstrations, marches, 'sit-ins' and 'sleep-ins' to secure what they think are legitimate objectives… Suddenly, it is clear that there are no more 'sacred cows' in American life.
>
> —United States Savings and Loan League,
> "Special Management Bulletin," 1974[1]

In 1972, Pat and John Cullanan decided they needed a bigger house for their growing family. For ten years, they had lived in a "modest wood frame" house in East Rogers Park, a middle-class community on the far northern edge of Chicago. They considered moving, but they loved their neighborhood. John had lived in the area for nearly forty years. Now, with a family, the couple had become active in their local church and PTA. So, they decided to take out a loan for an addition. The natural choice for a loan was the local S&L, Rogers Park Prudential.[2] The association had a long history in the community. With only $280 million in assets, it was small—a perfect example of the New Deal System's financial localism.[3]

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[1] William C. Prather and William B. O'Connell, "USSL: Special Management Bulletin," Dec. 30, 1974, "Mortgages Percy Wilson Mortgage & Finance Company, 1974-1975," Box 3, CAP - Dubi, Chicago History Museum.
[2] David Emmons, "Community Organizing and Urban Policy: Saul Alinksy and Chicago's Citizen Action Program (PhD diss., University of Chicago, 1986) 267.
[3] All dollar amounts are in constant 2015 dollars unless otherwise noted.

When Rogers Park Prudential denied the Cullanans' application for a $3,000 dollar home improvement loan ($17,000 in 2015), the couple was shocked and angered. There was nothing wrong with the Cullanans' credit—they had never missed a mortgage payment. Instead, as the loan officer explained, the S&L no longer made any loans in East Rogers Park. The Cullanans eventually found a bank that would lend to them, but they could not let the issue go. If Rogers Park Prudential was refusing to make loans in their neighborhood, was the area's long-term financial health in jeopardy? John began a "one-man crusade" to find out if what the loan officer had told him was true. He got in touch with neighbors to see if they had encountered similar difficulties in attaining home loans. To his dismay, he found his story to be typical. He made contact with other residents who could not get a mortgage or were required to make larger-than-normal down payments, some of whom had been encouraged by loan officers to quit searching for home finance in the city and move to the suburbs. That's where the money was.[4]

Rogers Park was mostly middle-class and overwhelmingly white. Its average income was slightly below the Cook County average. Though nearly 96 percent of its sixty thousand residents identified as "white" in the 1970 census, Rogers Park had a small but growing black population. Most of the 763 residents who identified as "black" lived in East Rogers Park near the northeastern border with Evanston, which had a significant black population. The black population was a mix of working-poor and upper-middle-income families, with few in between. Rogers Park, especially East Rogers Park, was also home to a smaller percentage of people who identified as living in a "husband-wife family," 48 percent, than the Cook County (64 percent) or national (69 percent) averages.[5]

[4] David Emmons, "Community Organizing and Urban Policy," 267.
[5] Social Explorer; U.S. Census Bureau; 1970 Census Users' Guide; U. S. Government Printing Office, Washington, D. C., 1970.

In early 1973, John Cullanan contacted the Citizens Action Program (CAP), a group founded in 1969 by working- and middle-class Chicagoans—"housewives, clergy, students, neighborhood activists, even a few scientists"— concerned about air pollution from the city's coal-fired power plants.[6] Initially called the Campaign Against Pollution, the group amended its name after its focus expanded beyond pollution to include taxes, highway construction, and cost-of-living issues. When Jack Cullanan appeared with his story of lending discrimination, CAP took up the issue. They protested, spread fliers, held rallies and demanded that Rogers Park Prudential release detailed lending data. When none of this worked, they began an organized withdrawal campaign. The money they withdrew never amounted to a huge sum—around $260,000. But for an association with only $280 million in assets, almost all of it in illiquid mortgages, a sudden withdrawal of more than a quarter million dollars made a difference in its day-to-day revenue flow. More importantly, the S&L feared that the publicity gained by such a coordinated effort would spark more withdrawals. According to the Tribune, the S&L's president "seemed to be visibly shaken by the protests." CAP's methods, according to him, amounted to "Gestapo tactics."[7]

Over the next several years, CAP took their campaign to other Chicago S&Ls. They found that Rogers Park Prudential was typical of broader trends in the city's home finance market. By the early 1970s, Chicago faced a massive capital drain to its suburbs. In 1972, the assessed valuation of the city's real estate dropped by $618 million while suburban Cook County gained $2.2 billion in assessed value.[8] Such a drop in the city's real estate was unprecedented in the postwar era. Increasingly, urban financial institutions refused to originate conventional

[6] Emmons, "Community Organizing and Urban Policy," 23.
[7] Frederick Lowe, "S&l Protestors Pull Out," *Chicago Tribune*, Jun 28, 1973.
[8] Jerry Kohler, "Profits!" *Lerner Booster*, Sep. 26, 1973, Box 6, CAP, University of Illinois at Chicago.

mortgages, not backed by the FHA or VA, in the city's working-class neighborhoods, white and black. This was especially true for areas that were integrated or nearby black or Latino neighborhoods. In such places, FHA Section 235 loans were often the only avenue to homeownership. Lender abuse and "panic peddling" became the norm as financial institution took advantage of the government's assumption of risk and the mortgage demand among the city's black middle class. Meanwhile, branching liberalization was making it easier for financial institutions to move to the suburbs. Interest rate volatility was tightening the market and endangering the soundness of financial institutions, especially for small, urban institutions. S&Ls thus looked to the suburbs, which they believed would offer safer and more lucrative investments.

CAP accused the city's financial industry of redlining—refusing to sell in neighborhoods because of prejudice – as it simultaneously worked to broaden the definition of the practice.[9] Redlining was not, as many suggested, limited to individual cases in which a financial institution flatly refused to make a loan in a certain area based solely on racial prejudice. Instead, it encompassed a host of intimate business practices and systematic biases, some explicit and open, others implicit or hidden. All of them privileged upper-class, racially homogenous suburbs at the expense of older, urban middle-, and lower-class neighborhoods, both white and black.

CAP's answer was "greenlining"—organized withdrawals from institutions that were using the savings of the urban working-class to finance the mortgages of the suburban upper-class. It seemed like CAP might succeed in stemming the flow of mortgage funds to the suburbs. They offered a powerful defense of financial localism, drawing on the rhetoric used by the industry itself. Local financial institutions, especially S&Ls, were not free to use local savings in

[9] For a history of redlining see Kenneth T. Jackson, *Crabgrass Frontier*; David Freund, *Colored Property*.

any way they wanted, CAP argued. Though held by S&Ls, the deposits were rightfully "the people's money."[10]

Groups such as CAP, whether they succeeded or failed, brought to light the problem of urban disinvestment and its structural causes. They were part of a broader surge in left-wing, grassroots politics during the 1970s that included labor, Black Power, feminism, and gay rights. CAP, led by a handful of Italian-American homemakers, did not fit easily into any of these traditional categories of Leftist activism. It had roots in the New Left, especially its use of direct action, and it relied on Saul Alinsky's prescription of raising class consciousness by mobilizing around specific issues that directly affected local residents.

CAP sought to construct as broad of a movement as possible in the white working class. The organization thrived off a growing sense among the white working class that the home finance system, which had benefitted them in the past, was now discriminating against them. CAP also formed cross-racial alliances by emphasizing common class experiences. In highlighting commonalities of class, however, CAP downplayed differences of race. In doing so, they opened their membership up to working-class whites who were hostile to or ignorant of the unique struggle facing black Chicagoans. CAP's silence on racial issues was a strategic choice of its leaders, who were well aware of systematic racial discrimination but chose not to highlight it. The strategy perhaps inhibited CAP's ability to build stronger connections to the city's black community, and it certainly was a serious omission from an otherwise powerful critique of structural bias.

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[10] "Redlining in Chicago," *CAP Action*, Jun. 1974, "CAP Action Newsletter April 1971 - Winter 1975," Box 6, CAP - Booth, Chicago History Museum.

The financial industry saw CAP and other groups like them as a serious threat. The U.S. Savings and Loan League (USSL) put out a special bulletin to all of its members warning them that such groups "should not be taken lightly." Organized withdrawals could lead to "[bank] runs and/or loss of control."[11] Many Chicago S&Ls ultimately negotiated with CAP in order to avoid becoming a target for "greenlining." The group successfully negotiated several agreements with S&Ls that included geographic lending requirements. Meanwhile, pressure from groups such as CAP gained some sympathy from local and state politicians. The city passed stronger lending disclosure requirements. Another working-class Chicago group, the National People's Action on Housing (NPAH), took the campaign to Washington, DC and won major legislative achievements in the Home Mortgage Disclosure Act (HMDA) and the Community Reinvestment Act (CRA). The HMDA, passed into law in 1976, required banks and S&Ls to disclose data about their home lending, most importantly the race and income of the borrower and the census tract of the property. The CRA, passed in 1977, required federal regulatory agencies to define goals for financial institutions in terms of local lending. The CRA also mandated that regulatory agencies take into account financial institutions' performance against these goals when approving branch applications and mergers and acquisitions.

Just as these groups were beginning to get traction, the terms of the struggle changed. Policymakers constructed the HMDA and the CRA to address urban disinvestment within the New Deal Home Finance System rather than the emerging Securitized System. The acts applied only to depository institutions and exempted the GSEs from disclosure and local lending goals. As the GSEs replaced depository institutions as the nation's primary source of funds over the following decade, the HMDA and the CRA became less useful in combating urban

[11] William C. Prather and William B. O'Connell, "USSL: Special Management Bulletin," Dec. 30, 1974, "Mortgages Percy Wilson Mortgage & Finance Company, 1974-1975," Box 3, CAP - Dubi, Chicago History Museum.

disinvestment. Meanwhile, branching liberalization was happening faster than community groups could react. The damage done by redlining could not be undone easily. And the government-sponsored secondary mortgage market increasingly eroded financial localism. In the twilight of the New Deal System, CAP's rhetoric of local control were less achievable and its tactics less effective. Fannie Mae was a far more formidable opponent than Rogers Park Prudential.

CAP Origins

On the morning of November 5, 1969, a thick fog settled over Chicago. It was no ordinary fog, though. Rich with pollutants like sulfur dioxide, the "eye-burning, throat-tickling dirty air" refused to dissipate. For six days it sat over the city, the result of an air inversion that trapped the city's dirty air. All the pollutants emitted from the city's cars, homes and industry stagnated over the city. The city reprogrammed its street lamps to remain on twenty-four-hours-a-day. At O'Hare and Midway airports, hundreds of flights were delayed as air-traffic controllers complained that they could not see the ground beneath their towers. "Motorists driving to work from clear-skied suburbs saw roads vanish in the blue-gray pall that hid the famous Chicago downtown skyline from view," according to the *Tribune*.[12] Hospitals saw an increase in flu cases and other respiratory maladies as sulfur dioxide and other pollutants reached dangerous levels. Chicago's health commissioner later calculated that there had been fifty more deaths than usual in the days following the air inversion.

[12] Casey Bukro, "Eye-burning, throat tickling dirty air hangs over Loop," *Chicago Tribune*, Nov. 7, 1969.

The Daley administration's response was forceful, if farcical. The city sent hundreds of police to patrol for unauthorized leaf and trash burning. Yet, the pollution released by individual leaf burning paled in comparison to that of Chicago's numerous industrial plants. Especially troublesome were ComEd's coal-fired power plants, which belched huge amounts of toxic sulfur dioxide into the air.

For Saul Alinsky's and the Industrial Areas Foundation (IAF), the air inversion and the city's response presented an opportunity to highlight the widely shared ills of pollution and to organize Chicago's middle class. In 1968, Alinsky had returned to Chicago after working in Rochester, New York. His time away had changed his perspective. The poor, particularly African Americans and Latinos, could not achieve social change without allies in the middle class, he believed. The middle class was also confronting its own challenges: inflation, pollution and regressive taxation, for example.[13] In the wake of the Vietnam War and the social movements of the 1960s, the middle class grew increasingly mistrustful of the nation's corporate and political elite. IAF organizers had first targeted white middle-class suburbs, but they met with little success. The air inversion redirected their attention to working-class urban neighborhoods, which were more directly affected by pollution than the suburbs. In the words of activist David Emmons, "The air inversion presented an invitation too appealing to refuse. A visible crisis had suddenly made pollution concrete, raised the public's hackles, and identified a target."[14]

Alinsky was aided in his efforts by *Daily News* columnist Mike Royko. Royko's muckraking columns were highly critical of Daley's Democratic machine, and when the inversion hit, he used his position to pressure the city government. Eager to see meaningful

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[13] Emmons, "Community Organizing and Urban Policy," 11-13.
[14] Ibid., 22.

action on the issue, he provided the IAF with hundreds of letters from readers complaining about the pollution. IAF organizers quickly set out to contact the letter-writers. Within weeks, organizers had assembled a core group of activists. Calling themselves the Campaign Against Pollution (CAP), organizers planned the first protest for December 15 at an Illinois Commerce Commission meeting where ComEd and other utilities would present pollution abatement plans. At the State of Illinois Building in downtown Chicago, broken elevators conveniently greeted 150 protestors. After climbing nineteen flights of stairs, the protestors found state police guarding the door of the meeting room. The police informed the protestors that there was not enough room for them to enter: company officials occupied nearly all the eighty-five seats in the meeting room. After a heated confrontation between protestors and police, the ICC Chairman agreed to let a handful of protestors testify before the commission. The ICC's stonewalling produced sympathetic press coverage, highlighting the cozy relationship between regulator and regulated. As Emmons, a CAP member who later wrote a dissertation on the organization, noted, "It was an auspicious beginning."[15] CAP successfully gained concessions from ComEd and an air pollution ordinance from the city council. CAP's attention soon spread to other polluters in the city. Campaigns followed against the release of toxins by a Sanitary District facility in Stickney, noise pollution from O'Hare airport, and the Glenview Naval Air Station and proposed nuclear plants.

At first glance, the air inversion had little to do with mortgages or banks. But, as IAF had hoped, the pollution campaign was only the beginning of a much broader campaign dedicated to organizing Chicago's working-class communities. It soon began campaigns against unfair tax

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[15] Ibid., 25.

assessment, cost-of-living issues, and a fight against the proposed Crosstown Expressway. In 1971, CAP changed its name to the Citizens Action Program to better reflect its multi-issue approach. By 1975, CAP had over one hundred local affiliates throughout the city and in some inner-ring, working-class suburbs. As the U.S. Savings and Loan League noted in 1974, groups like CAP tapped into a growing “dissatisfaction” with the “system” and mistrust of government and business. The organization also fed off a growing sense of disempowerment among the city’s white working class, many of whom felt that the best days of the postwar era were behind them. Alinsky recognized that this feeling of decline could—indeed, had—fueled reactionary politics, particularly directed against African Americans. But it was the job of CAP to redirect white working class frustration towards the corporate and political elite and find common cause with poor and non-white people. To that end, CAP’s portfolio of issues shared common villains: entrenched and corrupt corporate and political power, embodied by the city’s elite businessmen and machine politicians—“the political-financial combine that runs Chicago.”[16] In each area of protest, the organization highlighted the ways in which class and geography shaped the social distribution of costs and benefits. While upper-class white suburbanites benefitted from Chicago’s industry, the pollution it produced disproportionately affected middle- and lower-class urban and inner-ring suburban communities with large populations of people of color. While suburban commuters would benefit from a new Crosstown Expressway, the project would displace thousands of lower- and middle-class Chicagoans. While outlying upper-class suburbs enjoyed wide availability of mortgage funds, such funds were increasingly in short supply in working-class, urban communities.

[16] “Working Paper on Building Local Block Networks for Neighborhood Organization,” n.d. (1974), Folder 6, Box 1, University of Illinois at Chicago.

Of course, a host of postwar federal policies, cultural discourses, and business practices had been directing mortgage money to the metropolitan periphery for decades, but beginning in the early 1970s, several factors quickened the pace of the suburbanization of mortgage capital and, more broadly, reshaped the modes of capital mobility that enabled the process. Section 235 loans provided a convenient way for financial institutions to capitalize on black demand for housing and on white racism, while simultaneously disinvesting from neighborhoods undergoing racial transitions. Since 1934, FHA insurance had protected financial institutions from foreclosure losses, but now, with the advent of securitization and the growth of the secondary mortgage market, financial institutions were not just protected from loss. They could be guaranteed an immediate return from the resale of the mortgage and a long-term return from service fees. Such mortgage practices transferred risk from financial institutions to the federal government and, especially, black mortgagors. Meanwhile, financial institutions could reap the rewards of the dual housing market without exposing themselves to the risk of fluctuating home values in racially-transitioning neighborhoods. In the short-term, home values rose as blockbusters took advantage of white racism and black demand, buying from whites at rock-bottom prices and selling to blacks at exorbitant prices. But, over the long-term, financial institutions worried that such neighborhoods would inevitably experience a decline. It was often a self-fulfilling prophecy, a product of their own racist assumptions about African-American neighborhoods and the perception that other white business investments as well as municipal services would follow whites elsewhere. This decline was also aided in no small part by the usurious terms placed on black mortgagors, which increased the likelihood of foreclosure.[17]

[17] On blockbusting, see, for example, Amanda I. Seligman, *Block By Block: Neighborhoods and Public Policy on*

One of the communities facing rapid racial transition in the late 1960s and early 1970s was the West Side neighborhood of Austin. In 1967, Alinsky-acolyte Thomas Gaudette and a local homemaker, Gale Cincotta, founded the Organization for a Better Austin (OBA) to protest the blockbusting methods of local realtors. Cincotta would go on to found National People's Action on Housing (NPAH) and lead the Metropolitan Area Housing Alliance (MAHA), both of which helped to publicize the practice of blockbusting, or "panic peddling" as they more often called it, and redlining. Indeed, Cincotta's groups were central to efforts to popularize the term "redlining."[18]

FHA lending became a key issue for CAP and NPAH in the early 1970s. CAP's African-American members, particularly Secretary Hazel Montgomery and Southwest Area Vice President Walter Pratt, led the campaign against FHA lending practices. They picketed financial institutions involved in the Section 235 Program and took the fight to the Chicago office of the FHA. "Mortgage bankers lie at the heart of one of the greatest scandals of our time," Montgomery said. "Their thirst for quick profits and callous disregard for FHA forbearance guidelines are gutting our neighborhoods."[19] When homeowners defaulted and their mortgages and went into foreclosure, the FHA would assume ownership. Even Chicago FHA director John Waner admitted that there was "no doubt that the Federal Housing Administration is becoming the biggest slum landlord in Chicago."[20]

CAP drew heavily from the ideas advanced by the OBA, NPAH and MAHA – the organizations founded by Cincotta – but they differed in tactics, specific objectives, and main

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Chicago's Westside (Chicago: University of Chicago Press, 2005)

[18] Gregory D. Squires, ed., *From Redlining to Reinvestment: Community Responses to Urban Disinvestment* (Philadelphia: Temple University Press, 1992).

[19] "Mortgage policies assailed," *Chicago Tribune*, May 13, 1975.

[20] "CAP Fights FHA Abuse," *CAP Action*, Apr. 1974, "CAP Action Newsletter April 1971 - Winter 1975," Box 6, CAP - Booth, Chicago History Museum.

constituency. CAP devoted much energy to mobilizing as large a membership as possible. Its aggressive, direct-action tactics reflected this goal. According to CAP literature, their protests were acts of "guerilla theater" designed to "establish the reputation of CAP as a hard-hitting, plain-talking organization of people determined to win."[21] Although Cincotta's groups also utilized direct action, they devoted more energy to specific policy objectives and were relatively less concerned with producing the attention-grabbing headlines that fueled the growth of CAP's membership.

CAP's constituency was also whiter and wealthier than Cincotta's groups. Like NPAH, CAP argued that redlining was the main cause rather than the consequence of neighborhood decline. NPAH's origins in the racially transitioning neighborhood of Austin, however, contrasted with CAP's early focus on organizing the white working class throughout the city, and the issues they chose to focus on reflected these different beginnings. While NPAH highlighted "panic peddling," school overcrowding and, more broadly, achieving stably integrated communities, CAP was less concerned about integration and race in general, instead choosing to focus on expanding the definition of "redlining" to include white middle-class neighborhoods that were not under the direct threat of racial transition. CAP contended that redlining happened in nearly all of Chicago's communities outside of the Loop, the lakefront, and other upper-class enclaves. Indeed, in the early 1970s, shortages of mortgage funds, which had been endemic to African American communities throughout the postwar era, increasingly affected white neighborhoods, especially white, urban, working-class communities.

[21] "Working Paper on Building Local Block Networks for Neighborhood Organization," n.d. (1974), Box 1, Folder 6, CAP, University of Illinois at Chicago.

The Mortgage Market

The late 1960s heralded a new era of rising and more volatile interest rates, contributing to periodic disintermediation, where capital left mortgage markets in search of higher returns in securities' markets. In 1966, 1968, and 1973, as interest rates rose rapidly, mortgage credit was extremely difficult to attain. Many institutions even enacted temporary moratoria on mortgage lending. But the shortage of funds was not equally shared. Shortages were worse in already high-interest rate regions, like California. Shortages were also unequally distributed on a metropolitan scale. With mortgage funds tight, financial institutions increasingly relied on forward commitments with large-scale suburban developers. These agreements, made before construction began, gave developers and financiers predictability in a volatile market.

Indeed, more broadly, the volatile and tightening conditions favored large financial institutions over small ones. Larger institutions had the assets to weather periodic disintermediation. And they benefitted from larger networks of business partnerships, enabling them to more efficiently diversify their portfolios by directing funds when and where they could earn a stable return, by, for example, providing a forward commitment to a large-scale suburban development. Meanwhile, the changing market conditions squeezed smaller, urban institutions, especially Savings and Loans (S&Ls).

Organizing

CAP's first convention in March 1973 was testament to a growing sense of disempowerment among a diverse group of middle-class Chicagoans. The conference brought together hundreds of frustrated members of Chicago's middle class. According to the *Catholic Worker,* of those in attendance, "the most notable visible attribute of those present was their age: nearly all were between 35 and 65 years old [including] middle-aged couples [and] several hundred 'senior citizens.'" Indeed, CAP drew significant support from senior citizens groups. Its campaign for property tax equity resonated with many fixed-income retirees. CAP also mobilized senior citizens through its campaign to combat rising living costs in an era of inflation. Senior citizens were vital to CAP's anti-redlining campaign, too. As younger families increasingly moved to the suburbs, many retired homeowners stayed in the city, unhappy with changes in their neighborhoods and unable to sell their homes for a good price if they wanted to. At the convention, these senior citizens groups mixed with a "scattering of… 20s [sic] with shoulder length [sic] hair, casual clothes, and on men, beards and mustaches." CAP claimed over 3,500 members. A plurality was Catholic from "'silent majority' type parishes." There was also a "cross section of Protestants, Jews, [and representatives from] a few black units." Illinois Governor Daniel Walker addressed the proceedings via videotape, assuring the convention of his staunch opposition to the Crosstown Expressway. Studs Terkel, who had interviewed CAP activists on his radio program, served as a guest speaker.[22]

The success of the first convention was a product of years of careful organizing across the city. Vital to the organization's formation were IAF organizers Ed Chambers and Dick Harmon. They helped to recruit Paul R. Booth, the former SDS national secretary, who served as co-chairman of CAP from 1970 to 1973. Booth led CAP's pollution, property tax, and consumer campaigns. Prior to CAP, Booth worked as a researcher for the Amalgamated Meat Cutters and Butcher Workmen (AFL-CIO). In setting out to organize white Chicago homeowners, these left-wing activists built strategic alliances with people who did not always share their radical politics.

[22] David Sutor, "Chicago Group Voices Middle-Class Concerns," *Catholic Worker*, Apr. 6, 1973.

Most of CAP's members were, according to the *New York Times*, "conservative homeowners who vote straight Daley Democratic machine ticket." As the *Times* pointed out, CAP's critics "have labeled them 'radicals'—an appellation that amuses CAP officials," given that they were, in fact, "conservative" Daley voters.[23] Certainly, some CAP activists were neither conservative nor Daley voters, but many were. CAP was careful to remain mostly non-partisan in its approach. CAP focused on organizing around specific issues and outlining specific goals. Such an approach, activists believed, would allow the organization to build fruitful alliances, grow membership and gain tangible results. According to CAP literature, the organization owed its success to the "diversity" of the people it represented, from businessmen to military veterans to garden clubs and parishioners.[24]

IAF organizers quickly recognized that Catholic parish groups could prove fertile for recruitment. In an internal memo, Chambers and Harmon identified Catholic priests as lynchpins in building an effective movement against urban disinvestment. Parish gatherings offered a chance to make a case against redlining in front of a receptive audience. Beyond the home, the church often represented the strongest and most static link to the community and its history. Churches, especially Catholic parishes, were difficult to relocate. They also offered a chance to form strong interpersonal bonds between families and across generations, helping to create a shared community geography and history.[25] But for Chambers and Harmon, the appeal to priests was much more prosaic: "The approach to denominational leaders is not done on a moral basis, but is done on a financial basis, which is where they are most vulnerable, and that is the only thing that they care about; that is, that they are incompetent administrators if they do not use the

[23] William E. Farrell, "Small-Homeowners Press Chicago Banks," *New York Times*, May 3, 1975.
[24] David Sutor, "Chicago Group Voices Middle-Class Concerns," *Catholic Worker*, Apr. 6, 1973.
[25] John McGreevy, *Parish Boundaries: The Catholic Encounter with Race in the Twentieth-Century Urban North* (Chicago: University of Chicago Press, 1996).

institutional and individual monies to force financial institutions to restabilize parishes that they are having trouble with."[26]

Yet Chambers' and Harmon's cynicism about priests' motives was not always warranted. In public and often in private, the partnership between left-wing radicals and Catholics seemed a happy coalition. Many Catholic priests and parishioners cultivated their own grassroots radicalism. Many of these priests were deeply influenced by the Second Vatican Council. They sought greater community engagement and believed that the church should have a constructive role in addressing the social concerns of its parishioners. The antiwar and Civil Rights movements also furthered social and political engagement among clergy. John Mack, a Jesuit seminarian and IAF trainee, was one such clergyman. A mutual acquaintance led Mack to another clergyman, the Rev. Leonard Dubi. The son of a Chicago steelworker, Dubi had entered the priesthood eager to engage with social issues. At his first assignment on Chicago's Northside, Dubi had attempted to galvanize his parish around the issue of police brutality, only to find that there were many policemen in his parish. At his next assignment, St. Daniel the Prophet Church in Garfield Ridge, Dubi was able to find an issue that was more fruitful: pollution. Garfield Ridge was a white middle-class neighborhood on the Southwest Side. To its east was Midway Airport, and to the north and south were numerous industrial plants, including a Campbell's Soup Factory and a solid waste disposal plant. So when Mack approached Dubi about getting involved with CAP, Dubi was immediately interested. A group of parishioners from St. Daniel's attended the founding meeting of CAP and, impressed with CAP's organization, Dubi and a

[26] Ed Chambers and Dick Harmon, "Save our City Campaign," Oct. 8, 1973, Mortgages Greenlining, 1973-1975, Box 3, CAP- Dubi, Chicago History Museum.

group of his parishioners agreed to found a Garfield Ridge CAP chapter, which would grow to become one of CAP's strongest outlets.[27]

Not all of the priests involved in CAP were as politically ambitious as Dubi. The Rev. Albion Ciciora was a "short stocky priest" and pastor of St. Gall's Catholic Church in the Southwest Side community of Gage Park. Though predominately white at the time, Gage Park was under threat of racial turnover, as it was located just west of The Back of the Yards and northwest of West Englewood. Ciciora had gotten involved in CAP when he attended a meeting of a local affiliate, the Southwest Parish and Neighborhood Federation, which claimed some of his parishioners as members. As *The New York Times* reported, Ciciora "listened as homeowners told of rejection after rejection for mortgage loans. A decision was made, Father Ciciora said, to 'get a fair share of our savings dollars back in the community.'" Ciciora expressed a fatalistic attitude towards integration: "Chicago does not have integration. Integration is the time lapse between the time the first black family moves and the last white family moves out." The main objective of the CAP anti-redlining program, which he chaired, was the "preservation of existing neighborhoods."[28]

Though the leadership of CAP was mostly white, CAP also counted black community groups within its membership. According to the *New York Times*, CAP's limited integration fostered some "racial suspicions," but if racial divides were difficult to overcome, the common experience of class united them.[29] CAP reported particular success in finding common ground with middle-class African Americans over issues of city services, tax fairness, crime, judicial reform, and mortgage availability. By the summer of 1974, CAP literature boasted that "for the

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[27] Emmons, "Community Organizing and Urban Policy," 33-36.
[28] William E. Farrell, "Small-Homeowners Press Chicago Banks," *New York Times*, May 3, 1975.
[29] Ibid.

first time, South side blacks and Southwest and Northwest side white ethnics are working together to solve their common problems."[30]

Common ideas about family also united activists across racial, geographic, and class boundaries. A CAP memo outlined the central aim of its anti-redlining campaign: "Fundamentally, we are saying that we will allow financial institutions to use our savings only when & if they will use it to shape our communities according to our desires."[31] These desires were for a financial system that was more communitarian and egalitarian, but they were also desires for a heteronormative community—a community of "young families" with children.[32] A CAP flyer outlined the connection between mortgages and their version of the ideal community: "The life of a community is dependent on the number of families who maintain a vested interest in their schools, their property, the businesses and the religious and social institutions within the community. The ability of any Chicago community to draw new families to the area depends on the availability of mortgage money."[33] According to CAP, if financial institutions "cut off mortgage money… Chicago's neighborhoods will degenerate into places unfit for self-respecting citizens."[34]

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[30] "CAP Canvasser Seminar—Summer 1974," "CAP General Files Jan - Dec 1974," Box 2, CAP - Booth, Chicago History Museum.
[31] "Greenlining Drive: Phase II," "Greenlining- Mortgage Industry/Regulation 1973-1975," Box 2, CAP Dubi, Chicago History Museum.
[32] References to the plight of "young families are numerous in the CAP literature. For example, Citizens Action Program Congress of Community Organizations, "Greenling—A Plan to Revitalize Our Neighborhoods," "Greenlining- Mortgage Industry/Regulation 1973-1975," Box 2, CAP Dubi, Chicago History Museum; "Some Common Questions Concerning Savings and Loan Associations," Ibid.
[33] "Red-lining and Your Community," Folder 7, Box 1, CAP, University of Illinois at Chicago.
[34] Albert Jedlicka, "Citizens fight S&Ls for more mortgages, fewer relocations," *Chicago Daily News*, Jun. 22, 1973.

"Ordinary Housewives"

As CAP grew, women activists assumed more prominent roles. Mary Lou Wolff was elected the first president of CAP at the March 1973 convention. She was a forty-five year old Italian-American mother of nine from the northwest-side community of Mayfair. She described herself as "just an ordinary housewife."[35] Wolff first got involved in CAP during the campaign against the Crosstown Expressway. According to a 1972 profile in the *Tribune*, Wolff was a "silent housewife" before she left the "kitchen to fight city hall." Up until a few years prior, "her outstanding achievements… had been her fruit pies, children and clean home." When she married in 1950, "she did not believe in working wives [but] twenty-two years later, it seems Mary Lou Wolff has made the jump from the frying pan to the fire of political action without batting an eyelash." Now, the *Tribune* reported, she was a "fiery redhead." The turning point, Wolff recalled, was a mundane assertion of basic consumer rights. Three years before, when a butcher gave her a spoiled piece of meat, instead of accepting it, as she might have before, she returned it. It was "like opening a logjam," she told Studs Terkel in a 1972 radio interview. "I like getting what I paid for," she told the Tribune, "whether it's in the butcher shop or in Washington."[36]

Denise Ponzetti, a fellow CAP activist and friend of Wolff's, reported a similar transformation. Ponzetti, a "housewife" and mother of three, "used to be very conservative," Wolff said, "one of my most conservative friends." "I never opened my mouth," Ponzetti told Terkel. Was she a member of the "silent majority," Terkel asked? "All our views on a lot of things have changed," Ponzetti replied. The protests and the police crackdown at the 1968 Democratic Convention in Chicago were a turning point. She "saw the way we were pushed and

[35] Mary Lou Wolff and Denise Ponzetti Interview with Studs Terkel, WFMT, Dec. 13, 1972, Studs Terkel Radio Archive, Chicago History Museum.
[36] Ibid.

shoved…I just may not agree yet with all that went on but I can see where average Joe citizen got caught up in something like that. I can see their anger."[37] For mothers like Ponzetti and Wolff, the Vietnam War was a decisive issue.[38] Their children were less likely to go to college than the children of upper-class parents. They were more likely to be enlisted and more likely to suffer death or injury. The real or potential loss of a child to the war, and the class disparity in sacrifice, made the war both personal and political. When antiwar protests erupted in Chicago, however, polls suggested that most Americans, even if they were increasingly troubled by the war, supported the brutal police crackdown. But, at least for some, like Wolff and Ponzetti, doubts about the war and mistrust of their political leaders had grown to such an extent that they identified with the protestors at the Democratic Convention. They, "we" in the words of Ponzetti, were no longer silent.

The war was central to Ponzetti and Wolff's political transformation, but it was the proposed Crosstown Expressway that motivated their initial involvement in CAP. The Expressway would have cut right through their neighborhood, and the 1972 proposal slated the Ponzetti's house for demolition. The uncertainty was paralyzing. They couldn't sell their home even if they wanted to. They didn't want to put any money or effort into home improvement. When CAP took up the issue, Ponzetti and Wolff found a way to act. Consumer rights, the war, and the Expressway were all connected to a broader feeling of disempowerment that propelled them to get involved with CAP. When Terkel asked Wolff if she was a member of "the silent majority," Wolff replied:

[37] Ibid.
[38] Studs Terkel, *American Dreams: Lost and Found* (New York: Pantheon, 1980), 265-272.

> As you get to feel more and more frustrated about being able to in any way affect your life beyond deciding what color of paint you're going to put on the wall or what you're going to eat that night—even that you can't always decide because it depends on the prices—you get frustrated… This begins to press down on you. You either get angry or else you get hopeless about it… The most important thing about the whole experience… is that I suddenly understand after forty-five years… what it means to be a human being, to be a free person, to be able to make decisions about my life.[39]

It was a dramatic transformation. Yet, years later, in 1980, when Wolff recollected her political history in *American Dreams,* Studs Terkel's collection of short autobiographical essays, Wolff provided a somewhat different personal trajectory than the one she had given years earlier.[40] Well before she got involved with CAP, she had developed an acute political consciousness. Her father was a wood finisher and a son of immigrants from Sicily. Her grandfather and other men in the family "worked on the railroads out west [while] the kids and women stayed and farmed small plots of land." Wolff's parents enrolled her in St. Mary's Catholic High School where she joined a youth group called the Young Christian Students. It was in the group's discussion of papal encyclicals that she first became "aware of things like social policies about labor." She "had never heard about such a thing before, even though my father was a workingman." One of the encyclicals she most certainly read was the *Rerum Novarum* (On the New Things), issued by Pope Leo XIII in 1891, which decried the poverty of the working class, asserted the responsibility of employers to provide safe working conditions and a living wage, and affirmed the rights of laborers to organize unions (while also rejecting communism and asserting the right to private property).

The *Tribune's* assertion that when she married in 1950, "she did not believe in working wives," was a half-truth. In the final years of her teens, she did not want to become a

[39] Mary Lou Wolff and Denise Ponzetti Interview with Studs Terkel, WFMT, Dec. 13, 1972, Studs Terkel Radio Archive, Chicago History Museum.
[40] Studs Terkel, *American Dreams,* 265-272.

homemaker. Rather, she had wanted to earn a wage to achieve independence and her own place in the working class. She left college after a year believing that "to be a worker, to work in a factory, was the best thing of all."[41] In the early postwar years, it seemed possible to Wolff and many other working-class women that such a path was attainable. But, like many others, Wolff only found "boring," "dead-end" jobs: soldering radio parts, making paper boxes, waitressing. She briefly served as an editor for a magazine for working women published by the Young Christian Students. In 1950, when she was twenty, she "gave up and got married."At times, she was dogged by a feeling of "vague discontent," but then she would tell herself, "That was all kid stuff. Now you have responsibilities. Put those dreams aside. That's over and done with." From time to time, old friends would approach her and ask her to come give a speech, but she would always reply: "No, I'm a mother, I'm too busy." Her new friends were "all very nice." But she found recipe exchanges and conversations about home decor unfulfilling. It seemed like there was no one to talk to about big ideas, politics, or books. Even her husband would say, "Mary Lou, I don't know what you're talking about. What is it you want to talk about? Do you want to go out and buy a new dress?"[42]

Vatican II raised "questions of conscience" for Wolff, as did the Vietnam War. She didn't want her son to go to war. And as her children got older and more politically aware, they began to ask questions, ones that Wolff found difficult to answer. She convinced her parish's young new priest to convene an adult education meeting to talk about the "questions and upheavals" confronting the church, the nation, and their neighborhood. She met a new group of neighbors who shared her concerns, people she didn't even know existed before. Like Wolff, they had also

[41] Studs Terkel, *American Dreams,* 266.
[42] Ibid., 267.

felt “isolated” without anyone to talk to. But conversation wasn’t enough. They wanted to do something. So they started a parish organization to address neighborhood issues such as the dead elm trees that the city neglected to cut down, and the installation of traffic lights on a street that had been recently transformed from a quiet neighborhood street to a dangerous speedway. From their earliest campaign, they realized the ineffectiveness of pursuing action through the city’s political and municipal institutions. Officials were non-responsive. Direct action seemed to be the only way of getting a response.[43]

Wolff read about CAP in the newspapers. Its emphasis on creative and aggressive direct action appealed to her. “They broke the rules,” she said. The campaign against the Crosstown Expressway brought Wolff’s parish organization into CAP’s fold.[44] At one protest, Wolff watched as CAP’s chairman, the Rev. Dubi, confronted a city alderman, Roman Puchinski, asking him if he had a personal financial interest in the Expressway’s construction. As Wolff recalled, the alderman responded, “If you weren’t a priest, I’d punch you right in the nose.” At which point, Dubi removed his collar and said, “Go ahead and punch, try it.” Wolff was enthralled by the priest’s brazen challenge. She was “impatient about too much talk” and CAP offered an avenue for action. Indeed, CAP was eager to tout Dubi’s willingness to aggressively confront powerful political and corporate leaders.[45] CAP literature boasted that he had been “shoved by the City Council sergeant… and questioned by Mayor Daley, ‘What kind of a priest are you?’”[46]

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[43] Mary Lou Wolff and Denise Ponzetti Interview with Studs Terkel, WFMT, Dec. 13, 1972, Studs Terkel Radio Archive, Chicago History Museum.
[44] Ibid.
[45] “CAP Canvasser Seminars Summer 1974,” Box 2, “CAP General Files Jan - Dec. 1974,” CAP - Booth, Chicago History Museum.
[46] Ibid.

For women such as Wolff and Ponzetti, CAP's direct-action tactics were personally liberating. Through their political activism, they challenged not only alderman but also their husbands and the gender norms that shaped their personal lives. The unfairness of their unpaid domestic labor came into sharper focus as they spent more time outside of the home. It was a "liberating experience," Wolff told Terkel. "I realized," Ponzetti said, "that the kitchen floor does not have to be washed once a week. I can go to a meeting and do something rather than get down on my hands and knees and scrub that kitchen floor." Political activism offered more than just liberation from the arduous duties of homemaking. CAP's aggressive direct-action tactics also offered freedom from the gendered rules of etiquette that left women like Wolff feeling stifled. Wolff recalled her early days with CAP: "Here, suddenly, was a group of people I liked, admired, saying: 'You don't have to always be polite.'" The story of returning the spoiled piece of meat to the butcher could sound quaintly amusing in isolation, but it was part of a much more powerful political awakening—one that extended from the home all the way to the highest levels of political power.

During her time at CAP, Wolff often chose not to publicly highlight the deeper roots of her political activism. The story of an apolitical homemaker transformed into political activist had the narrative power to captivate a whole class of "ordinary housewives" from diverse political perspectives.[47] Indeed, Wolff was deft in cultivating a political persona that could appeal to a broad audience. Her decision to return to political activism, she claimed, was part of a broader "awakening [of the] silent majority of black and white middle-class Americans who are tired of paying taxes, voting, writing polite letters in the hopes of getting change… for us in the

[47] Wolff's story was similar to other contemporary women activists, such as Betty Friedan. See, for example, Daniel Horowitz, *Betty Friedan and the Making of the Feminine Mystique: The American Left, the Cold War, and Modern Feminism* (Amherst: University of Massachusetts Press, 1998).

middle-class, there is not much left but to do as we're told. That doesn't leave us much dignity."[48] The feeling of disempowerment drove "ordinary housewives" like Wolff to adopt confrontational, direct-action tactics. Some labeled them "radical," but "the embrace of these tactics was merely because nothing else worked," Wolff said. Corporate and elected officials were too entrenched, too powerful to challenge by any other means. "The silent majority is waking up," Wolff said, "I'm part of it. I'm not a college graduate or a Woman's Libber. I'm not radical or even liberal. I just want a break for the common people. We're the backbone of this country."[49]

Wolff and other women activists in CAP often expressed their political identity in terms of their roles as mothers and wives. Their rights and responsibilities as mothers served as the foundation of their political identity. Concern for their children drove their political activism. And the knowledge they gained as mothers gave them unique insight into issues regarding the home and neighborhood. This knowledge, they argued, included the true state of "deterioration" of the neighborhood. They noticed when trees on their streets died, litter accumulated in the gutter, parks fell into disrepair, schools became overcrowded, church attendance dropped, and shops closed. When African Americans moved nearby, they were also perhaps more likely than their husbands to know their new neighbors. Because of this knowledge, they could tell the difference between the problems that posed risks to neighborhood stability and those that did not. The men that controlled the home finance industry did not have this knowledge. Too often, activists charged, these men were prejudiced against low- and middle-class urban communities. Or, if not, their justifications betrayed a lack of concern for communities and their families.

[48] Cornella Honchar, "Silent Housewife Leaves Kitchen to Fight City Hall," *Chicago Tribune*, Nov. 5, 1972.
[49] Mary Lou Wolff and Denise Ponzetti Interview with Studs Terkel, WFMT, Dec. 13, 1972, Studs Terkel Radio Archive, Chicago History Museum.

Motherhood provided a powerful political vocabulary for activists like Wolff and Ponzetti, but they also had to struggle against narrower conceptions of motherhood that proscribed political activism. The *Tribune's* recounting of Wolff's political awakening—how she "jump[ed] from the frying pan to the fire of political action without batting an eyelash"—was tinged with condescension. The profile offered the story of the "fiery redhead" as both a serious piece of reporting— a story that could pique the interests of other disenchanted homemakers—and also as an object of amusement for readers, especially men, who might laugh at the idea of an expert fruit-pie-maker becoming a political leader.

The cost of transgressing conservative gender roles could be much greater than condescending media coverage. Mary Lou Wolff's husband, Kenneth, did not support his wife's political activities. He was a supervisor at Bell Telephone, one of the utility companies that CAP protested for its rising rates. In 1973, Mr. Wolff sued his wife for divorce arguing that she was an "unfit mother because she was gone from the house too often and that the only thing that mattered to her was the Citizen's Action Program." Mrs. Wolff countered that her activities as a mother and an activist were intertwined. Her work on important political issues, like education and crime, was done for the benefit of her children. The knowledge she gained through her political activism had "brought a whole new dimension of concern for her children." Her children encouraged her and liked seeing her on TV, she said. The judge agreed with Mr. Clark and awarded him sole custody of their five minor children and occupation rights to their house in Mayfair. Having lost her children and her home, Wolff resigned the presidency of CAP in November 1974 and accepted a salaried position as a full-time organizer for the AFL-CIO.

The Rogers Park Campaign

According to CAP, Rogers Park was "a neighborhood of solid older homes on tree-lined streets…just the kind of neighborhood you might choose to move to, to bring a family up in, and to enjoy retirement in."[50] But, the threat of disinvestment was looming: "underneath its pleasant exterior, it is a neighborhood fighting for its life." Local residents, particularly in East Rogers Park, had difficulty obtaining mortgages, and realtors and S&L lending officers often tried to convince them to look elsewhere, namely the suburbs.[51] According to a realtor interviewed for a *Bill Moyers' Journal* episode on redlining in Chicago, S&L officers often responded to requests for mortgage lending in East Rogers Park with "hysterical laughter."[52] The availability of mortgage funds was rapidly decreasing. Data released by the Chicago Federal Home Loan Bank in February 1974 indicated that S&Ls had invested about half as much in mortgages in the area in 1973 compared to 1972.[53]

In March 1973, the Rogers Park CAP began its anti-redlining campaign against local financial institutions that refused to finance local mortgages. They demanded that local financial institutions release data on local lending. Community members, activists claimed, had a right to know where S&Ls were investing their money. "These are our homes and these are our institutions," one flyer explained.[54] Banks and S&Ls refused to comply. In May, CAP decided to change tactics. Drawing on their experience with ComEd, organizers fanned out into the community to collect pledges from local residents that they would withdraw their money from any institution that refused to release lending data.

[50] "Redlining-Slow Strangulation of community," *CAP Action* (Jun. 1973), "CAP Action Newsletter April 1971 - Winter 1975," Box 6, CAP - Booth, Chicago History Museum.
[51] Terry B. Brown, "Playing it safe," *WSJ,* Apr. 5, 1974.
[52] "Redlining Exposed On National Television," *CAP Action*, Dec. 1973, "CAP Action Newsletter April 1971 - Winter 1975," Box 6, CAP - Booth, Chicago History Museum.
[53] "Stipp Study Reveals Red-Lining," *CAP Action*, Mar. 1974, "CAP Action Newsletter April 1971 - Winter 1975," Box 6, CAP - Booth, Chicago History Museum.
[54] Rogers Park Citizen Action Program, Folder 6, Box 1, CAP, University of Illinois at Chicago.

In June, activists targeted Rogers Park Prudential S&L for the group's first organized withdrawal. The association's president, John N. Langworthy, was serving a term as the Illinois Savings and Loan League (ISSL) president and the protests offered an opportunity to bring more public attention to the issue of redlining. Activists claimed that the S&L sent most of its money to upscale and suburban neighborhoods while redlining nearby neighborhoods. Langworthy refused to release lending data, claiming that his institution "consider[ed] Rogers Park one of the most desirable sections of the city, but there are cancers in certain areas… If we make poor loans we have to answer to our depositors and supervisory agencies."[55] A few days later, several dozen "determined" members of CAP "with passbooks in hand" and placards that read "Green Power," walked into Rogers Park S&L and withdrew about $240,000 in protest. CAP president Mary Lou Wolff admitted the amount was a "small drop in the bucket" compared to Rogers Park's $264 million in assets. But Wolff maintained that the demonstration would raise public awareness and weaken the S&Ls position. Other withdrawals, she said would soon follow. Langworthy continued to deny that the S&Ls practices amounted to redlining, but the demonstrations were certainly successful in gaining his attention. According to the Tribune, he "seemed to be visibly shaken by the protests."[56] CAP's methods, according to Langworthy, amounted to "gestapo tactics" and he demanded to know "what type of persons" belonged to CAP and where their funding came from.[57]

The Rogers Park campaign raised public awareness of the issue and contributed to CAP's growing political influence. Rep. Frank Annunzio (D-8th) and Daniel Rostenkowski (D-11th) agreed to attend a CAP meeting on July 5, 1973, at which CAP leaders presented two primary

[55] Albert Jedlicka, "Citizens fight S&Ls for more mortgages, fewer relocations," *CDN*, June 22, 1973.
[56] Frederick Lowe, "S&l Protestors Pull Out," *Chicago Tribune*, Jun 28, 1973.
[57] "S&L Board Raps Tactics of CAP," *Chicago Tribune*, Jul. 5, 1973.

demands they hoped to achieve with the Congressmen's help: an immediate freeze on all new S&L branches and relocations and full disclosure of lending data. Annunzio and Rostenkowski agreed to organize a meeting with other Chicago representatives to introduce CAP leaders to Rep. Wright Patman, chairman of the House Banking and Currency Committee, which was preparing to hold committee meetings to discuss redlining.

The campaign against Rogers Park Prudential achieved publicity and "exhilarated" activists, yet it ultimately failed in its specific objectives. Though Langworthy may have been distraught, he never acquiesced to CAP's demands.[58] CAP was unable to muster enough withdrawals to seriously trouble the S&L. Moreover, without readily available lending data, activists were unsure of where to redirect members' withdrawals. Activists saw the issue as having great potential but realized that if such campaigns were to be successful, they would need more planning and more pledges. They would need to make it a citywide issue.

Redlining Redefined

In the aftermath of the Rogers Park Campaign, CAP worked to broaden the definition of "redlining." As a 1973 CAP newsletter put it, "every neighborhood in the city is affected to some extent by the channeling of their resources to the suburbs or to the luxury market."[59] If "young families" were unable to find mortgages in city neighborhoods, CAP warned, they would be "forced to purchase their homes in the suburbs and our property values will drop."[60] "Thru redlining," CAP argued, "stable neighborhoods are devoured; it leads them thru the stages of

[58] Emmons, "Community Organizing and Urban Policy," 274.
[59] "Redlining," *CAP Action*, May 1973, "CAP Action - Newsletter April 1971 - Winter 1975," Box 6, CAP - Booth, Chicago History Museum.
[60] "Some Common Questions Concerning Savings and Loan Associations," "Greenlining- Mortgage Industry/Regulation 1973-1975," Box 2, CAP Dubi, Chicago History Museum.

deterioration to urban renewal to redevelopment—which will profit the same financial community that initiated the process."[61]

According to CAP, redlining was both pervasive and subtle, as when realtors and bankers quietly "steered" white prospective homebuyers to the suburbs. In the aftermath of the Civil Rights Movement, the industry was not as overt in its discrimination as it had been before. Instead, discriminatory lending patterns were often the product of the private, intimate business relationships between developers, financiers, realtors, and state regulators. As the Rev. Albion Ciciora explained to a special legislative committee investigating redlining in 1974, "arbitrary loan judgments based on a 'red line down Western Ave.,' or a 'red line down Kedzie Ave.' continue, but, in addition, redlining has now become a far more subtle, sophisticated practice." Instead of outright denial, S&Ls and banks would "steer young families out of our neighborhood into 'choice' suburban developments," Ciciora said. They would offer better terms for suburban mortgages or use excuses, such as the age of the house, to deny the loan.[62]

Perhaps most importantly, "redlining" was systematic, and in fact, transformations in the structure of the home finance industry during the early 1970s were worsening systemic patterns of urban disinvestment, according to CAP. Money was increasingly flowing to affluent, distant suburbs. Neighborhoods that were home to the middle-class "silent majority," once the beneficiaries of the postwar home finance system, were now facing the prospect of economic decline. "When mortgage money becomes tight in all communities," CAP's leadership wrote to

[61] Mary Leonard, "Citizen groups battle home loan 'redlining,'" *Chicago Today,* Sep. 12, 1973, Folder 1, Box 6, CAP, University of Illinois at Chicago.
[62] "Greenlining Drive: Phase II," "Greenlining- Mortgage Industry/Regulation 1973-1975," Box 2, CAP Dubi, Chicago History Museum.

Governor Walker, "the problem… in older neighborhoods becomes catastrophic."[63] A CAP flyer explained:

> Tight money means there is less mortgage money to divide between all of the communities of the metropolitan area. This means the older and changing communities that didn't get much mortgage money when money was available, get even less when money is tight. There are mortgage loans being made in the Chicago…and being made with our savings. Yet very few of these loans are going to our communities… If you want to see where loans are being made look any week in the Tribune or Daily News real estate sections. Sales in multi-million dollar developments are advertised every week with downpayments [sic] as low as 5%, private mortgage insurance, and frequently interest rates as much as a point below what we have to pay… Tight money is a problem mainly for the class of small home buyers who—ironically enough—are also the savers who support the S&Ls.[64]

Exacerbating the problem of tight money was the use of forward commitments by large-scale developers and financial institutions. S&Ls would sign an agreement with developers in advance of construction guaranteeing mortgage financing when the homes were finished and sold. In 1973, almost two thirds of S&Ls' mortgage investments in Cook County were invested in this way. In testimony before state legislators, Wolff outlined how the system of forward commitments disadvantaged older, urban communities. S&Ls claimed that "redlining" was an isolated problem. According to S&Ls, it did not count as "redlining unless a person is told point blank that he cannot get a mortgage because of the geographic area in which he wishes to buy," Wolf said. "In fact," she went on:

> the system of forward commitments itself means that the suburbs and lakefront are much more likely to get mortgage money than older city neighborhoods. The relationship between large developers and S&Ls implicit in the forward commitment prevents the free functioning of competition for mortgage money… this system leads inevitably to the disinvestment of mortgage funds from the older

[63] Wolff, et al., to Walker, Jun. 17, 1974, Folder 6, Box 1, CAP, University of Illinois at Chicago.
[64] "Greenlining Drive: Phase II," "Greenlining- Mortgage Industry/Regulation 1973-1975," Box 2, CAP Dubi, Chicago History Museum.

> neighborhoods. And this would be true even if the S&L industry never consciously redlined any areas—which of course they do also.[65]

More than overt, individual acts of discrimination, "redlining" was, in fact, the systematic outflow of mortgage money from lower class urban neighborhoods to upper class suburbs and urban areas. The system divided S&L customers into "two classes," Wolff argued: the large, suburban developers and "the ordinary home buyer."[66] Large-scale developers were able to tap "unlimited mortgage funds for suburban development, while at the same time those who wish to purchase older homes in the city are forced to compete for the remaining limited amount of lendable capital." CAP literature echoed Wolff's appeal to basic fairness and "free competition."

One example was Olympic S&L, located in the inner-ring western suburb of Berwyn. Berwyn was just west of Cicero. Like Cicero, it was overwhelmingly white. Many of its residents were middle class and of Italian and Eastern European descent. 99.6 percent of its residents identified as "white" in the 1970 census. Only ten residents identified as "black" and 660 as "Spanish origin or descent" out of a total population of 52,502. Average family income was $77,000, just below the Cook County average. Among Olympic's forward commitments was a "multimillion dollar development of condominiums and townhouses" located about ten miles west of Berwyn in the more affluent suburb of Elmhurst. Homes there sold for as much as $350,000. Homebuyers enjoyed down-payments "as low as 5 percent, private mortgage insurance, 9.4 percent interest, and 30 year terms," according to CAP. Olympic also had forward commitments for developments in even more distant suburbs, including townhouse developments in Hanover Park and Hoffman Estates, which were twenty-five and thirty miles

[65] Mary Lou Wolff, "Forward Commitments Prove Wholesale Red-lining," *CAP Action*, Aug. 1974, "CAP Action Newsletter April 1971 - Winter 1975," Box 6, CAP - Booth, Chicago History Museum.
[66] Ibid.

away from Berwyn, respectively.[67] Wolff's testimony and evidence provided by CAP was key to the committee's determination in its final report that redlining of older, urban neighborhoods did indeed exist across much of Chicago.

The appeal to equity between the city and suburbs and a "free functioning" system of "competition" was rhetorically powerful and a sincere goal of activists, yet it was only a baseline for action. In fact, as Wolff argued, urban residents looking for a mortgage had "first claim," or "first priority" to the lending resources of their local financial institution.[68] A CAP flyer put it in stark terms: "Chicago is being slowly strangled by the lack of mortgage money, as Savings and Loans, with our dollars, systematically march to the 'greener pastures' in DuPage County."[69] When savers deposited their money in local financial institutions, activists argued, they retained at least some say in how and where that money was to be invested. In particular, financial institutions had the duty to invest savings dollars in the communities from which they came.

This was especially the case for S&Ls, CAP activists believed. S&Ls were unique institutions unlike other businesses. Rather than shopping their lendable funds to the highest bidder, S&Ls had a responsibility to invest in the communities from which they drew their savings and in which they had historical roots. The defense of S&L disinvestment as merely sound business practices was grounded in the "most prevalent misconception concerning Savings and Loan," a CAP flyer explained.[70] In fact, the flyer went on, S&Ls "were set up by the people in a neighborhood or small town so that citizens could pool their resources in a mutual association, controlled by the depositors, in order to foster homeownership." They were "unique

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[67] Ibid.

[68] Testimony of Mary Lou Wolff, CAP President, Illinois Legislative Investigating Commission, August 1, 1974; Wolff, et al. to Walker, Jun. 17, 1974, Folder 6, Box 1, CAP, University of Illinois at Chicago.

[69] "Lending Practices of Savings and Loan Associations," n.d., "Mortgages Greenlining, 1973-1975," Box 3, CAP - Dubi, Chicago History Museum.

[70] "Some Common Questions Concerning Savings and Loan Associations," "Greenlining- Mortgage Industry/Regulation 1973-1975," Box 2, CAP Dubi, Chicago History Museum.

to America" and "the principle reason why so many Americans have their own homes compared to other countries." Historically, S&Ls "aided the development of the home neighborhood—people deposited their money in these institutions knowing that their neighborhood would grow and prosper as a result."[71] As CAP's newsletter argued, "S&L assets… are the people's money, collected for the social purposes of reinvestment."[72] Providing savings accounts and home loans was the "traditional role of Savings and Loans in a community, and for many years the system worked well." But "today, in many cases Savings and Loans are trying to abandon their original purpose."[73]

Increasingly, S&Ls were sending their money out of the community. Executives were asserting control over their institutions at the expense of depositors, CAP charged, keeping decisions about where to invest money out of public scrutiny. "Annual meetings are kept secret," the flyer said, and "depositors are denied the most basic information concerning the Associations [sic] lending policy." They were pushing state and federal legislation that "would allow them to become more like commercial banks, so that they can become stockholder corporations, invest in much more than residential mortgages, and take over whatever control the depositors still have." In fact, as neighborhood associations with public responsibilities, S&Ls' lending patterns and other data should be made public, CAP argued. The "public has a right to know… the *real* lending policies of a Savings & Loan."[74]

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[71] Ibid.
[72] "Redlining in Chicago," *CAP Action*, Jun. 1974, "CAP Action Newsletter April 1971 - Winter 1975," Box 6, CAP - Booth, Chicago History Museum.
[73] CAP Press Release, June 23, 1973, "CAP Convention (Congress) Agendas," Box 4, CAP - Booth, Chicago History Museum
[74] Ibid. Emphasis in the original.

CAP's argument that financial institutions, especially S&Ls, served a unique public role—that they were not simply private business enterprises—carried significant currency in the early 1970s. S&Ls had long touted their public service and the mutual-ownership structure that dominated most of the industry. Their role as community-based institutions designed to encourage the formation of ideal family and community types (in racial, gender and class terms)—rather than to generate private profits—had a long and powerful historical genealogy, rooted in the social ethos of the New Deal, the Progressive Era, and, going even further back to the First and Second Great Awakenings in Britain and the United States. It was in this context that CAP asserted the public nature of S&Ls. CAP's position was echoed by sympathetic politicians. Rogers Park's state representative, Joe Lundy, lent his support: "while banks and Savings and Loans may be privately owned, they are *public* institutions, both in the sense that they are chartered and regulated by government in the public interest, and in the sense that they are in business to serve the public." State Senator Esther Saperstein agreed: "It is the legal responsibility of Savings and Loans and banks to serve the people in the neighborhoods where they are located."[75]

In January 1974, pressure from CAP, NPAH, and other groups resulted in the adoption of anti-redlining regulations from the state S&L commissioner. It was a significant victory, but one that carried more symbolic than substantive importance. According to the new regulations, the definition of "redlining" was limited to "'the practice of arbitrarily varying the terms or application procedures or refusing to grant a mortgage loan within a specific geographic area on the grounds that the specific parcel of real estate proposed as collateral for the loan is located within said specific geographic area." Instead, S&Ls "shall consider only sound underwriting practices which include: (i) the real estate proposed as collateral (ii) the willingness and the

[75] "Political Leaders Speak Out on Redlining," Folder 7, Box 1, CAP, University of Illinois at Chicago.

financial ability of the proposed borrower to repay the loan (iii) diversification of the association's investment portfolio (iv) conformance with long-established lending practices which are not violative of law." S&Ls could not "arbitrarily vary the terms of… loans because of… [the borrower's] race, color, religion, national origin, age, sex, marital status." Of course, proving that S&Ls acted "arbitrarily" would be difficult. If an S&L could provide documentation that met any of the broad criteria of the "sound underwriting practices," the association was not engaged in "redlining" as defined under the new regulations.[76]

Branching

The decision of federal, and then state, regulators to open the door to S&L branching in 1971 was yet another way for financial institutions to suburbanize their mortgage investments, according to CAP. In May 1973, CAP formed the Anti-Deterioration Coalition to bring the redlining issue to a wider audience. The coalition brought together activists from more than a dozen city neighborhoods and inner-ring suburbs. All but one of these communities were exclusively white. Several were on the Southwest Side (Chicago Lawn, West Lawn, Marquette Park), just to the west of the majority-black South Side. Many of the communities represented were on the North side, relatively distant from black neighborhoods: Irving Park, Mayfair, and Logan Square. The coalition also brought together representatives from North Austin and Belmont Cragin, which were on the Northwest Side, closer to the growing black West Side. The coalition also included representatives from two suburbs: Addison, located in eastern Du Page County, and Cicero, the exclusively white working-class suburb just to the West of the majority-

[76] Office of the Savings and Loan Commissioner, "Non-Discriminatory Lending Regulation," Jan. 17, 1974, "Mortgages Greenlining, 1973-1975," Box 3, CAP - Dubi, Chicago History Museum.

black Chicago community of West Englewood. The only community with a significant black population was the South Side community of South Shore, which was just to the Southeast of Hyde Park on Lake Michigan. During the 1960s and 1970s, South Shore underwent a dramatic racial transition, going from nearly 99 percent white in 1960 to about two-thirds black in 1970 to nearly all black by 1980. The coalition's first objective was to rescind S&Ls' newfound branching and relocation powers. According to CAP, "branching is a manifestation of the basic problem of red-lining." Activists warned, "if local associations cut off mortgage lending—through relocation or branching—Chicago's neighborhoods rapidly will degenerate into places unfit for self-respecting citizens."[77] Even after S&Ls moved their headquarters to the suburbs, a 1973 CAP press release argued, "branches serve as conduits to funnel money OUT of our neighborhoods." S&Ls, CAP argued, should invest in "the future of our communities and not the crackerbox suburbs in DuPage county."[78]

Members petitioned state and federal regulators to freeze all branching and relocation applications until a more thorough study of the issue could be completed. Such a freeze would hopefully give CAP more time to obtain lending data and convince regulators of the devastating impact that branching and relocation had on older, less affluent communities. CAP was hopeful it would have a receptive audience with state regulators. In 1972, Daniel Walker, a former aide to Adlai Stevenson, ran as an anti-machine reform candidate for governor. In the Democratic primary, he defeated Daley's chosen candidate, Lt. Gov. Paul Simon, and went on to narrowly win the general election against incumbent Richard B. Ogilvie. Activists in CAP applauded Walker's victory. Hopeful for meaningful change, CAP leaders wrote to Gov. Walker in June

[77] Albert Jedlicka, "Citizens fight S&Ls for more mortgages, fewer relocations," *Chicago Daily News*, June 22, 1973.
[78] CAP Press Release, "Demand Annunzio and Rostenkowski Take Action To Stop Red-lining," Jul 5, 1975, "CAP General Files Jul 1973 - Dec 1973," Box 2, CAP - Booth, Chicago History Museum.

1973. In exchange for raising the usury ceiling (the maximum interest rate that institutions could charge on mortgages), which was a major objective of the S&L industry, CAP advocated legislation that would allow the governor to declare a "Housing Credit Emergency." Once this emergency was declared, financial institutions would have to create two separate "credit windows": one for their primary service area and one for outlying areas. Institutions would not be able to originate mortgages outside their primary service area, including all forward commitments, until all qualified applications from within the area had been approved.[79] It was an ambitious objective, one never likely to succeed, even with a receptive governor.

Yet CAP did succeed in getting the governor's attention. In August, Walker agreed to meet with CAP concerning his selection of a new state S&L commissioner. Activists asked that the governor appoint a commissioner who was not an officer of an S&L (most state regulators were also S&L executives, creating significant conflict-of-interest issues), and they were pleased when he selected an attorney, Albert Pick III, and introduced him to community activists before he introduced him to the press.[80] In October, activists were further encouraged when Pick attended an "Accountability Session" on redlining sponsored by CAP. Pick listened as numerous Chicago residents told of their difficulties in obtaining home loans. The CAP newsletter, *Action*, reported that Pick showed "concern" for the residents and reiterated his opposition to redlining. Pick promised to develop new anti-redlining regulations and agreed to a temporary freeze on new branch applications. It was, according to Pick, "the beginning of the beginning of getting

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[79] Wolff, et al., to Walker, Jun. 17, 1974, Folder 6, Box 1, CAP, University of Illinois at Chicago.
[80] "Governor Nominates S&L Commissioner For Illinois," *Cragin Anti-Crosstown Community Association Newsletter*, Sep. 1973, "CAP General Files Jul 1973 - Dec 1973," Box 2, CAP - Booth, Chicago History Museum.

something done."[81] In January 1974, activists were further encouraged when Pick fulfilled his promise by issuing anti-redlining regulations. Though it was lacking in enforcement mechanisms, CAP called it a "good beginning."[82]

CAP also achieved substantial, if limited, progress with federal regulators. Both CAP and NPAH pushed the FHLBB for disclosure of its members' lending data, but in John Stipp, the president of the Chicago FHLBB, they found a stubborn opponent. "Even if redlining existed," Stipp told *Chicago Today*, "it would be questionable whether we would have any legal authority to tell savings and loans how and where they should be underwriting mortgages and loans. A Savings and Loan manager is a private businessman who has the responsibility of operating to protect the savings of his depositors; where mortgages go are his decisions and his risks."[83] According to Stipp, the solution to urban disinvestment was a matter of personal and business ethics. It would come through residents "sticking it out" and financial institutions fulfilling their "social and community responsibilities." Recognizing CAP's growing political importance and the potential problems it presented to the S&L industry, Stipp nonetheless agreed to meet with CAP representatives on August 27. At the meeting, seventy-five representatives from CAP presented the case for greater accountability from the FHLB and the industry. Charlie Roche, president of the Belmont-Irving Community Association, a CAP affiliate, confronted Stipp: "Your salary, this office, and your fancy suit were paid for with our savings." Stipp refused to support mandatory disclosure of S&L lending data but agreed to include representatives from CAP and NPAH on an FHLB Ad Hoc Committee to study redlining. It was "a major victory"

[81] "Pick Faces People," *CAP Action*, Oct. 1973, "CAP Action Newsletter April 1971 - Winter 1975," Box 6, CAP - Booth, Chicago History Museum.
[82] Memo, "Progress since September 1973," Folder 45, Box 6, CAP, University of Illinois at Chicago.
[83] Mary Leonard, "Citizens groups battle home loan 'redlining,'" *Chicago Today,* Sep. 12, 1973.

according to CAP's newsletter, demonstrating the "determination" of community leaders like Roche.[84]

After several meetings, the Ad Hoc committee agreed to distribute a voluntary questionnaire to S&Ls requesting data on lending patterns. Out of a total of 189 S&Ls, 127 volunteered information. Despite CAP protests, FHLB officials decided to release lending data only by zip code, omitting the lending patterns of specific S&Ls. Yet, the evidence was clear: financial institutions were redlining much of Chicago. NPAH turned to researchers at Northwestern University's Center for Urban Affairs to study the data.[85] They found that financial institutions had virtually shut off conventional mortgage lending in Black and Latino neighborhoods. The only home loans available in these neighborhoods were FHA loans. But, the shortage of conventional mortgage money extended well beyond racially transitioning neighborhood, radiating outwards for blocks and consuming huge sections of exclusively white neighborhoods. Financial institutions, the data strongly suggested, were refusing to lend in such neighborhoods because of the possibility of future integration. It was not only money that was leaving these neighborhoods; it was also the institutions themselves, which, through branching and relocation, were moving beyond the city limits. "The departure of neighborhood savings and loan facilities begins before and not after the racial change," researchers found.[86]

To demonstrate, the Northwestern researchers tracked each home loan originated from 1969 to 1972 in a nine-square-mile section of the Northwest Side, bounded by Irving Park, Western, North, and Cicero avenues. In the southeastern corner (nearly a third of the total area),

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[84] "Anti-Redlining Campaign Pushes Ahead," *CAP Action* (Sep. 1973), "CAP Action Newsletter April 1971 - Winter 1975," Box 6, CAP - Booth, Chicago History Museum.
[85] Beryl Satter, *Family Properties*, 370; Scott Jacobs, "Redlining— Do They or Not?" *Chicago Sun-Times*, Apr. 28, 1974.
[86] Scott Jacobs, "Redlining, other factors, threaten white areas, too," *Chicago Sun-Times*, Apr. 30, 1974.

home to a significant and growing Black and Puerto Rican community, nearly all mortgages were FHA insured. In the northwestern corner, which was nearly all white, only a small minority of the mortgages was FHA insured. In the middle stood "a buffer zone," where mortgage lending was split between FHA and conventional loans. The research also revealed that a growing black population could spur disinvestment in neighborhoods more than a mile away. Lastly, the researchers argued that redlining was not only the product of the "push" factors of racial discrimination against Blacks and Latinos; it was also the product of the "pull" to suburbia. Large financial institutions, such as insurance companies, were leading a capital exodus to the suburbs. As they invested in large projects like shopping centers, S&Ls followed, financing huge, suburban tract developments. A bias towards new rather than old structured the housing market and led to higher rates of return in suburban areas, researchers stated. As mortgage money tightened and investors demanded higher yields on real estate investments, the pull to suburbia intensified and the drain on the city's financial resources grew. Both push and pull factors meant redlining afflicted a growing number of urban neighborhoods, including many that were exclusively white.[87]

CAP's study of the FHLB data similarly condemned the suburbanization of finance capital but, in contrast to the Northwestern study's emphasis on the way race structured the mortgage market—in white and black neighborhoods alike—CAP chose to emphasize the class and geographic dimensions of redlining. As the CAP newsletter put it, suburban residents received thirty-one cents in mortgage investment per savings dollar while residents of older, urban neighborhoods received only eight cents per savings dollar.[88] Throughout Chicago, working-class neighborhoods were experiencing steep declines in mortgage investment. Total

[87] Scott Jacobs, "Redlining, other factors, threaten white areas, too," *Chicago Sun-Times*, Apr. 30, 1974.
[88] "Stipp Study Reveals Red-Lining," *CAP Action*, Mar. 1974, Box 6, "CAP Action Newsletter April 1971 - Winter 1975," CAP - Booth, Chicago History Museum.

lending by the 127 S&Ls during the period between July 1972 and July 1973 increased by more than 11 percent from the year before. Meanwhile, Austin and East Rogers Park received less than half as much in mortgage lending. South Shore received 65 percent less, Edgewater 45 percent, Lake View 43 percent, Roseland 37 percent, and South Chicago 24 percent. According to CAP, "during a year when older neighborhoods were being repeatedly told that mortgage money was virtually unavailable, loans were being made in the suburbs in record amounts." S&Ls' defense that mortgage shortages were merely the product of a "credit crunch" was nothing more than an "excuse" to funnel money to the more profitable suburbs.[89]

In June 1974, CAP and other groups achieved another victory when the Illinois Housing Development Authority (IHDA) announced a new program designed to encourage increased local investment by smaller S&Ls and banks in Chicago. The IHDA borrowed $109 million in low-interest loans from private lenders that it planned to invest in these financial institutions with the requirement that they use the money for mortgage lending in their local communities. Though significant, CAP viewed the IHDA program as merely "a stopgap measure." What was really needed was a "legal requirement that loan applicants from an institution's service area get first claim on its available money."[90]

The Greenlining Program

Frustrated with the piecemeal progress of regulatory and legislative reform, CAP searched for a more direct approach. If CAP could force S&Ls to originate more conventional, or non-FHA-insured, mortgages in their neighborhoods, it would make it in the S&Ls' "interest to maintain

[89] Ibid.
[90] "Loans for Lenders," *CAP Action*, Jul. 1974, "CAP Action Newsletter April 1971 - Winter 1975," Box 6, CAP - Booth, Chicago History Museum.

property values in our communities, to minimize instability and to prevent deterioration."[91] It would also "give the institutions an incentive to invest in redevelopment programs, shopping areas, etc." CAP challenged financial institutions' assessment of their neighborhoods. In fact, CAP argued, "our communities are not 'deteriorating areas." CAP activists argued that their communities did not represent poor investments for financial institutions. But, "if the Savings & Loans restrict mortgage money from our communities, then their statements that loans in our neighborhood are 'too risky' will become *self-fulfilling* prophecies."[92] Communities needed local financial institutions, according to CAP: "a community is alive and well as long as there is money available from the local institutions for home improvements and the normal buying and selling mortgages."[93]

The early phases of CAP's anti-redlining campaign had targeted relatively small neighborhood S&Ls such as Rogers Park Prudential. These smaller institutions, with their historic ties to specific neighborhoods, represented the easiest targets for CAP both in terms of rhetoric (they were supposedly neighborhood associations) and practicality (their small size meant organized withdrawals were more threatening to their financial security). But in January 1974, CAP activists decided to take their protest to the shareholder meeting of the state's largest thrift association, the Loop's First Federal.[94] Perhaps more than any other S&L, First Federal epitomized the "political-financial combine" that activists claimed "ran" Chicago. Its board of directors included executives from the city's largest utility, real estate, and banking companies, two of whom also served on the 1971 Non-Partisan Committee to Re-Elect Mayor Daley. Also

91 "Greenlining Drive: Phase II," Box 2, "Greenlining- Mortgage Industry/Regulation 1973-1975," CAP Dubi, Chicago History Museum.
92 Ibid. Emphasis in original.
93 CAP Press Release, June 23, 1973, Box 4, "CAP Convention (Congress) Agendas," CAP - Booth, Chicago History Museum.
94 First Federal's $6.9 billion in assets meant that it was among the twelve largest S&Ls in the nation, but compared to the elite financial institutions of today, it was tiny—a testament to the speed of consolidation that the industry would witness over the following decades.

serving on the board was one of the Daley machine's most powerful lieutenants, George W. Dunne, president of the Cook County Board of Commissioners (a position he held from 1969 to 1991). First Federal's chairman was E. Stanley Enlund, a trustee of the Better Government Association and a vice-president of the Citizens for (Republican Senator Charles) Percy Finance Committee.

The First Federal campaign required careful advanced planning. Activists had opened accounts months before the meeting to gain access. CAP activist-shareholders challenged First Federal's refusal to release lending data to the FHLB or even its own shareholders. Aware that tangible results would be difficult to obtain from such a large association (their shares amounted to only a small minority), activists attempted to maximize publicity in order to achieve at least a symbolic victory. A CAP flyer publicizing the protest featured an image of a twenty dollar bill with Andrew Jackson replaced by Enlund. "Put your money where your mouth is, Stanley!" the flyer read. Drawing on a piece Enlund had written in the latest issue of First Federal's magazine, CAP noted:

> his fond memories of the old days—the iceman, the milkman, skating in the streets, etc., etc.—proof, surely of his and First Federal's commitment to us. Mr. Enlund neglects to tell us that First Federal's $1,307,723,296 in assets [$6.9 billion in 2015 dollars] have in the past been committed first to the real estate speculators and developers of the Tierra Grande Courts in Country Club Hills, The Trails of Woodfield, and the The Groves of Hidden Creek, in Palatine, to mention a few, while the savers of Rogers Park, Logan Square, Abondale, Marquette Park, Calumet Park, Chicago Lawn, North Austin, Maywood, Bellwood, Broadview and Cicero see their neighborhoods slowly starving for lack of ready cash development… We call this REDLINING.
>
> We Too have fond memories—and we are prepared to put our money where our heart is… We call this GREENLINING.[95]

[95] CAP Flyer, n.d., Folder 45, Box 6, CAP, University of Illinois at Chicago.

According to activists, Enlund admitted at the shareholders meeting that the association "discriminates against some mortgage lenders merely because of the neighborhood in which they wish to buy: Sauganash [an upper-middle class neighborhood on the far northwest side of the city], he admitted, would receive different treatment than Rogers Park, which would receive different treatment than South Shore." Enlund refused, however, to disclose lending data. CAP activists responded by announcing that they would target First Federal for an organized withdrawal of savings funds and, as the meeting came to a close, they "unrolled a symbolic 'greenline' of dollars leading out of First Federal and back into the neighborhoods of Chicago."[96]

On March 31, 1974, more than two thousand delegates from scores of neighborhood groups met at the Palmer House Hotel for the second annual CAP convention. It was, according to the *Tribune*, "an angry and defiant gathering where mortgage bankers were called 'parasites,' public officials were compared with 'cheap underworld hit men,' and Mayor Daley was thrown in with the 'leeches,' who hope to build a Crosstown Expressway." The convention program covered a variety of topics. Delegates approved resolutions against rising food, drug, and fuel prices, high property taxes and utility rates, the proposed Crosstown Expressway, and lender abuse of FHA mortgage financing.[97]

Gathering the majority of attention, however, was the approval of an aggressive, direct-action campaign to force S&Ls to invest more of their money in local mortgage financing. Activists proposed to "exercis[e] our only real power over the S&Ls—our money."[98] Dubbed "Greenlining," the campaign attempted to use consumer power to pressure banks to invest in low- and middle-class Chicago neighborhoods. As defined by CAP's plan for the program,

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[96] "Enlund Refuses Disclosure," *CAP Action*, Jan. 1974, "CAP Action Newsletter April 1971 - Winter 1975," Box 6, CAP - Booth, Chicago History Museum.
[97] Michael, Kirkhorn, "CAP Votes to Put Its Money Where Its Friends Are," *Chicago Tribune*, Apr. 1, 1974.
[98] "Save the City—Save the Neighborhoods," Mar. 31, 1974, "CAP General Files Jan - Dec 1974," Box 2, CAP - Booth, Chicago History Museum.

"greenling" was "neighborhood residents, organizations, and institutions leveraging their monies to guarantee investment in their neighborhoods."[99] As with the Rogers Park campaign, activists would collect pledges from community members to move their savings deposits from banks and S&Ls with poor local lending patterns to those that invested more of their funds locally, particularly in mortgages. But this time the effort would be larger, covering numerous communities across the city. CAP activists modeled the "Greenlining" program after a similar program in Minneapolis called the "Save the Cities" campaign. Sponsored by several community organizations, "Save the Cities" targeted local Catholic parishes and priests for pledges to move their money to S&Ls that invested in local mortgages on fair terms.[100] Redlining was the "major cause of neighborhood deterioration in Chicago," CAP activists argued, and "Greenlining is the long term solution."[101] The stakes were high: "failure in this fight means the financial strangulation of Chicago."[102]

Greenlining would "not work overnight," CAP activists acknowledged. It would take years to reverse the effects of redlining. The current situation was dire. In many areas, residents found it difficult, often impossible, to find loans to fix up their homes, and prospective residents could not obtain a mortgage. "Financial institutions deliberately have shunned mortgages in inner-city areas," CAP charged.[103] Instead of investing in the "inner-city," financial institutions

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[99] Citizens Action Program Congress of Community Organizations, "Greenling—A Plan to Revitalize Our Neighborhoods," "Greenlining- Mortgage Industry/Regulation 1973-1975,"Box 2, CAP Dubi, Chicago History Museum.
[100] Ed Chambers and Dick Harmon, "Save our City Campaign," "Mortgages Greenlining, 1973-1975," Box 3, CAP - Dubi, Chicago History Museum.
[101] Citizens Action Program Congress of Community Organizations, "Greenling—A Plan to Revitalize Our Neighborhoods," "Greenlining- Mortgage Industry/Regulation 1973-1975,"Box 2, CAP Dubi, Chicago History Museum.
[102] "Save the City—Save the Neighborhoods," Mar. 31, 1974, "CAP General Files Jan - Dec 1974," Box 2, CAP - Booth, Chicago History Museum.
[103] Scott Jacobs, "Savings to be used as clout in seeking area mortgages," *Chicago Sun-Times*, Oct. 27, 1974.

sent savers' money to suburban and lakefront development. Meanwhile, homes and stores were abandoned and crime increased in the city's lower class neighborhoods. Even churches had difficulty acquiring loans for repairs and improvements.[104]

In its campaign, CAP was aided by the growing wealth of data provided by S&Ls as part of their applications to branch or relocate. Fairfield S&L, located in Bucktown, drew 53.1 percent of its savings from its home neighborhood and nearby but invested only 2.2 percent of its loan volume there. Nearly 60 percent of its mortgage loans went to suburban areas. Mid-America Federal S&L, located in Cicero with $1.04 billion in assets disclosed lending as part of its application to relocate thirteen miles west to Clarendon Hills. Already, Mid-America was investing slightly more than half of its mortgage funds in Clarendon Hills and surrounding areas even though it only received 14 percent of its savings from the area. CAP provided numerous other examples.[105]

Importantly, of the communities targeted by the Greenlining Program, some were undergoing racial turnover and others were close to such areas. Some, like Bucktown, had few black residents but a growing Latino, predominately Puerto Rican, community. Many targeted communities, however, were not directly in the path of racial change. Homeowners in white lower- and middle-class communities throughout much of the north and west sides and suburbs, such as Rogers Park, Uptown, Berwyn, and Calumet Park, reported difficulty in obtaining home loans.[106] For instance, in 1973, Olympic Savings, which filed geographic lending data with the state as part of its application to relocate from the inner-ring suburb of Berwyn to the more

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[104] Citizens Action Program Congress of Community Organizations, "Greenling—A Plan to Revitalize Our Neighborhoods," "Greenlining- Mortgage Industry/Regulation 1973-1975," Box 2, CAP Dubi, Chicago History Museum.

[105] "Lending Practices of Savings and Loan Associations," n.d., Box 3, "Mortgages Greenlining, 1973-1975," CAP - Dubi, Chicago History Museum.

[106] See for example Ibid.; Albert Jedlicka, "Citizens fight S&Ls for more mortgages, fewer relocations," *Chicago Daily News*, Jun. 22, 1973.

distant suburb of Lombard, held $338 million in savings from residents nearby its home office—those that lived in Berwyn, Stickney, Cicero, Riverside and North Riverside. Yet, in fiscal year 1971, the association only provided 28 new loans, worth less than $4.6 million to the same area.[107]

By October 1974, CAP had received pledges worth more than $224 million from residents who promised to move their deposits to financial institutions that were investing more of their money locally. The thousands of pledge cards that CAP collected represented "the most exciting and significant project that Chicago has ever seen," activists said. It was, according to CAP, a growing movement of "citizens who care about keeping our neighborhoods decent."[108] The total would continue to rise through the winter, hitting $330 million by February from more than seventeen thousand individuals and "hundreds of neighborhood institutions such as churches, businesses, and local unions."[109] By May, the total passed $500 million. As impressive as these pledges were, they represented a small fraction of the amount held in S&L savings accounts in the city, deposited at scores of different S&Ls scattered across the city. Furthermore, pledges were no certain guarantee that depositors would actually withdraw their money if and when CAP requested. Yet activists hoped that even a relatively small but substantial organized withdrawal could put S&Ls in an acute liquidity squeeze. S&Ls held a small fraction of their assets in cash—about two percent—that they used for normal business transactions. If activists could deplete an S&Ls cash reserves and force it to sell off the next-most liquid asset type (government securities) or borrow from the FHLB, the S&L would face a quick and significant

[107] Albert Jedlicka, "Citizens fight S&Ls for more mortgages, fewer relocations," *Chicago Daily News*, Jun. 22, 1973.
[108] "Save the City Bulletin," July 1974, Box 6, Folder 45, CAP, University of Illinois at Chicago.
[109] CAP Greenlining Coalition, Press Release, Feb. 5 1975, "Greenlining- Mortgage Industry/Regulation 1973-1975," Box 2, CAP Dubi, Chicago History Museum.

downgrade in its financial stability.[110] The threat of such a scenario, activists hoped, would be enough to convince S&Ls to sign agreements committing to increased local mortgage investment.

CAP entered negotiations with S&Ls with very specific goals for local investment in mind. The demand for mortgages in the local community, the size of the targeted financial institution, and the amount of savings dollars they received from their local community determined the specific dollar amount demanded by CAP.[111] The Greenlining program not only pursued specific dollar pledges from financial institutions for local investment; it also demanded that institutions follow through on their commitments and do so fairly and openly. CAP sought promises from banks to spend at least as much advertising the availability of local mortgage financing as they spent on advertising savings accounts to local residents. They also sought disclosure of lending patterns. And they pressured financial institutions to treat customers with FHA loans more fairly.

In Rogers Park, where activists had failed to win an agreement with nearby S&Ls, the local CAP affiliate eagerly embraced the new tactics of the Greenlining drive. Activists went door-to-door asking residents to sign pledge cards for the drive. Several local Catholic and Protestant churches and Jewish synagogues agreed to print CAP flyers in their weekly bulletins. On the opening day of the pledge drive, July 2, 1974, activists were able to collect pledges totaling $19 million. Judy Eyring, the Rogers Park CAP president, was overjoyed. "With the

[110] "Greenlining, CAP Convention 1975," Folder 45, Box 6, CAP, University of Illinois at Chicago.
Box 2, [111] "Greenlining Drive: Phase II," Box 2, "Greenlining- Mortgage Industry/Regulation 1973-1975," Box 2, CAP Dubi, Chicago History Museum.

enthusiasm and commitment of Roger Parkers, we can do anything," she wrote in the CAP newsletter.[112]

In North Austin, CAP's Greenlining campaign targeted four S&Ls.[113] Austin Federal, with assets of about $360 million, drew 58 percent of its savings dollars from its home neighborhood of Austin and the nearby neighborhoods of Humboldt Park, Belmont Cragin, and Hermosa while only investing 15 percent of its loan volume in these communities. "Keep our money in the community not in DuPage County," read a flyer that urged residents to attend a meeting sponsored by two local community groups that were affiliates of CAP.[114] In January, the strategy paid off when Austin Federal announced an agreement with CAP. The S&L pledged $14.75 million in local mortgages for the coming year. The agreement also required Austin Federal to provide these mortgages at prevailing interest rates. Furthermore, Austin Federal agreed to provide quarterly reports to activists regarding local mortgage lending.

On the Southwest Side, parish members of St. Gall, led by Ciciora, and two other Catholic parishes in the Chicago Lawn neighborhood, just to the south of Gage Park, embarked on a campaign to stop the planned relocation of several area S&Ls. The parish groups demanded that if S&Ls wanted to open suburban offices, they had to retain their old offices as their headquarters. Parishioners also demanded that S&Ls disclose lending data to the public. In January 1975, they achieved their first major victory when Southwest Federal signed an agreement pledging $3.4 million in local mortgage lending for the year. Activists hoped that the agreement with Southwest would give them leverage with other institutions. Their next target

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[112] Judy Eyring, "Rogers Park Greenlining Success," *CAP Action,* July 1974, Folder 45, Box 6, CAP, University of Illinois at Chicago.
[113] "Greenlining Drive: Phase II," "Greenlining- Mortgage Industry/Regulation 1973-1975," Box 2, CAP Dubi, Chicago History Museum.
[114] Flyer, "CAP General Files - Undated," Box 3, CAP - Booth, Chicago History Museum.

was Chicago S&L, located just across the border (Western Ave.) from Chicago Lawn in the West Englewood neighborhood. Chicago S&L was attempting to relocate its headquarters to the northwest suburb of Des Plaines. The campaign in Gage Park was difficult, but CAP was able to get a few S&Ls to disclose lending data. "Their own figures condemned them," Ciciora said. In April 1975, the group decided to target one of these institutions, Republic Federal S&L, for its redlining program. After negotiations, CAP attained a pledge from Republic for $2.8 million of local mortgage investment. Though significant, the amount was only a fraction of the assets held by Republic, which totaled more than $90 million.[115] When Crawford S&L, located in nearby West Lawn, refused to sign a similar agreement, CAP activists staged the first organized withdrawal under the new Greenlining Program and directed account holders to redeposit their money in Republic or Southwest Federal. CAP was not alone in pressuring banks and S&Ls to invest more locally. On the north side, in the Edgewood and Uptown neighborhoods, the Organization of the North East achieved a "voluntary pact" with two banks, an S&L, and a credit union for $11 million in local investment and disclosure agreements.[116] CAP, however, was unable to attain an agreement with Crawford. Indeed, forcing more than a token handful of banks and S&Ls to change lending practices proved difficult. In May, shareholders of Avondale S&L on the northwest side voted to support their board in rejecting CAP demands that they increase local investment.

State regulators expressed sympathy with the goals of the Greenlining Program but remained concerned about the tactics and effects of the campaign. "Basically, we support CAP's intention," said Timothy E. Griffin, the state savings and loan commissioner. Even so, he characterized CAP's tactics as "threatening "to neighborhood S&Ls and warned, "We don't want

[115] William E. Farrell, "Small-Homeowners Press Chicago Banks," *New York Times*, May 3, 1975.
[116] Scott Jacobs, "Savings to be used as clout in seeking area mortgages," *Chicago Sun-Times*, Oct. 27, 1974.

to be pushing any association that's now on the borderline into going under." Instead, the state wanted to "pump some lifeblood into the whole industry."[117]

CAP confronted police when they targeted Beverly Bank, located on the far Southside, in November 1974. Beverly might have seemed an unusual target. *The Defender* featured numerous articles praising Beverly for its community involvement as well as its employment of several black and women officers. Beverly, according to the *Defender*, was a "people-oriented bank… long interested in a policy of helping its neighbors."[118] It sponsored and hosted seminars on financial planning for black businesses, families, and retirees. One of its black officers, Henri Bryson, initiated an Urban Affairs Department designed to assist black entrepreneurs in starting and expanding businesses. The Urban Affairs Department also coordinated several community outreach programs, including a literacy program, neighborhood crime watches, a scholarship program, and "community stability" projects. Bryson would go on to become a vice-president of the bank and head its commercial banking department, while also coordinating the bank's policy of "conscientiously promoting the hiring and advancement of blacks throughout the organization." *The Defender* also touted the bank's hiring of several black women in key positions. Bettina Porter, an economist at the University of Illinois and a vice-president of the bank, headed the real estate department. Shirley Pickett, an "action-oriented… woman-on-the-go," served as the bank's community relations officer. When Beverly opened a new annex, both the manager and assistant manager were black women.[119]

Yet, according to CAP, Beverly was guilty of the same disinvestment practices as other banks in the area. Notwithstanding its numerous outreach and publicity campaigns and its hiring

[117] Ibid.
[118] "Beverly Bank Gets Involved," *Chicago Defender*, Sep. 26, 1970.
[119] "Beverly bank has many blacks in top positions," *Chicago Defender*, May 22, 1971.

of African American men and women, the bank funneled money out of its neighborhood and into wealthier and suburban areas. When it did invest locally, it often financed or owned apartment buildings operated by "slumlords," charging exorbitant rates for poorly maintained housing. Take, for example, a three-story, six-apartment building in the Southside community of Jackson Park Highlands that Beverly owned. In October 1972 city inspectors cited the building with forty-four separate code violations, which included, according to the *Defender*, "virtually every possible infraction of structural, electrical, plumbing, fireproofing, and sanitation rules."[120] By June 1974, the violations still had not been corrected because of fifteen court continuances.

After negotiations between CAP and Beverly over community lending practices broke down, CAP took to the street. On November 15, 1974, more than a hundred CAP members gathered at Beverly Bank to protest its lending policies. They were led by the Rev. Ciciora and CAP's African American secretary, Hazel Montgomery. As reported by CAP's newsletter, bank guards "pushed and cursed" CAP leaders before bank officials "commanded" police to arrest them. The police arrested Ciciora, Montgomery, and another leader, Chuck Lief, and charged them with disorderly conduct. It was an "outrage," according to Montgomery, that police would arrest "community people fighting for the survival of the south and far south sides. We are asking for… reinvestment of our savings dollars, for full disclosure of lending and savings policies—and what kind of treatment do we receive? We are abused by bank guards and arrested by Chicago police."[121]

A week later, CAP members returned to protest at Beverly Bank. This time, bank officials and police chose a more subtle method than arrests. They called in the Chicago Police's Tactical Unit, which used cameras to record protesters as they picketed the bank's office. "It

[120] "Slum City," *Chicago Defender*, Jun. 5, 1974.
[121] "Greenlining lives on the far south side," *CAP Action*, Winter 1975, "CAP Action Newsletter April 1971 - Winter 1975," Box 6, CAP - Booth, Chicago History Museum.

looks like we're getting closer to that inner core of power that the financial institutions want to protect… [and] the financial institutions are reacting by calling on police power to support money power," said Ciciora.[122]

CAP activists also believed that in order to truly "save our neighborhoods," the Greenlining program would have to go beyond neighborhood banks and S&Ls and target the large Loop banks. Downtown commercial banks were major recipients of city bank deposits. And in the same way that S&L deposits were "the people's money, collected for the social purposes of reinvestment," city bank deposits, CAP argued, "are our money, collected by taxes for social purposes."[123]

In 1975, CAP released a study indicating that the city's largest banks refrained from home loans outside of the Loop and lakefront areas. Six of Chicago's eight largest banks provided data on their geographical lending to the city as a precondition for receiving city deposits. CAP touted the disclosure as the "first submitted to any local government in the United Sates."[124] During 1973, these banks provided only $16.5 million for home loans outside of the Loop and lakefront areas.[125] As CAP pointed out, this represented less than .043 percent of the banks' $38 billion in combined assets. "These figures suggest that the large banks which are at the cornerstone of the Chicago money market are at the center of the deterioration problems of our neighborhoods," argued the Rev. Ciciora. As "leaders of the Chicago business community,"

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[122] Ibid.
[123] Citizens Action Program Congress of Community Organizations, "Greenling—A Plan to Revitalize Our Neighborhoods," "Greenlining- Mortgage Industry/Regulation 1973-1975," Box 2, CAP Dubi, Chicago History Museum.
[124] CAP Greenlining Coalition, Press Release, Feb. 5 1975, "Greenlining- Mortgage Industry/Regulation 1973-1975," CAP Dubi, Box 2, Chicago History Museum.
[125] Jerry De Muth, "Accuse Loop banks of home loan lag," *Chicago Sun-Times,* Feb. 5, 1975.

these bankers, Ciciora argued, "set the pace and priorities for the development of metropolitan area housing, commerce and industry."[126]

Bank executives claimed that such loans "did not fit in with their primary target." It wasn't that they were turning their backs on Chicago's neighborhood. Rather, they had never been the "traditional" source of such mortgage financing; S&Ls and smaller neighborhood banks had filled this role. As a spokesman for Continental Bank (the state's largest, with $22 billion in assets) explained, "most deposits in major Loop banks come from business and industries worldwide and most lending is concentrated in this area to meet the needs of customers." Loop banks lent their assets to a variety of different investments, such as securities, bonds, and large business loans. Their total home loan lending amounted to $240 million, or 0.6 percent of their total assets. The $16.5 million in home loans to Chicago neighborhoods outside of the Loop and lakefront areas represented less than 7 percent of their total home lending.[127]

Activists contested Loop banks' claims that they were only serving the needs of their large corporate clients in neglecting local home financing. In areas that lacked a bank or an S&L, such as large parts of the black South and West Sides, residents who could afford to bank often turned to the large Loop banks. "The downtown banks are in a real sense local banks," claimed Hazel Montgomery. Residents of the South and West sides often had no alternative. As Montgomery pointed out, Englewood residents had $23.8 million in savings accounts and $11.2 million in checking accounts at Loop banks. Residents from West Garfield Park and South Austin, also majority black neighborhoods, had $41 million in savings and $13.2 million in checking accounts at Loop banks.[128]

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[126] CAP Greenlining Coalition, Press Release, Feb. 5 1975, "Greenlining- Mortgage Industry/Regulation 1973-1975," CAP Dubi, Box 2, Chicago History Museum.
[127] Jerry De Muth, "Accuse Loop banks of home loan lag," *Chicago Sun-Times,* Feb. 5, 1975.
[128] Ibid.

In addition to protesting the disinvestment of financial institutions in the city's lower-class neighborhoods, CAP also campaigned against the disproportionate investment of city redevelopment funds in the downtown area. In February 1975, CAP released another study that found that between 1973 and 1977, current and planned expenditures for the central business district totaled nearly $1.2 billion in the areas of "transportation, environment, leisure time and recreation, protection of people and property, health, housing and community improvements, and municipal facilities." The total for the rest of Chicago was $1.5 billion. Thus, as CAP put it, the downtown received "88 times more in capital improvement funds, per square mile, than do the city's neighborhoods."[129]

"A New Militancy"

If few of these campaigns produced tangible results, activists could at least claim that they caught the industry's attention. S&L executives saw the National People's Action on Housing and the Citizens Action Program as formidable threats to their business practices. A 1974 "Special Management Bulletin" from the USSL described their "Guidelines for Management Response to Activist Groups." "In the 'open society' of the 1970s," the bulletin began, "the relationship between savings and loan associations in the United States and the 60 million savers they serve have become the subject of growing interest." For one, growing interest stemmed from the ""huge growth of the business and its increasing importance." The bulletin also noted that the "consumerism movement" focused more "attention on the relationships between savings associations and their customers." In the "age of accountability," the "rising interest in savings

[129] Citizens Action Program, "Analysis of City of Chicago's Capital Improvements Program," n.d., "Greenlining-Mortgage Industry/Regulation 1973-1975," Box 2, CAP Dubi, Chicago History Museum.

and loan corporate decisions and procedures is not unusual." Indeed, the bulletin cited a host of reasons for the "growing interest":

> Over the past turbulent decade the American society has been subjected to unusual stresses and strains. These include an unpopular war, double-digit inflation, Watergate, racial tensions, growing dissatisfaction with the failure of the 'system' to function as effectively as in the past, and a growing questioning of government at all levels and of the performance of major institutions, including the business system. A new militancy over the resolution of economic and social issues has been created. Encouraged perhaps by the growing importance of television, groups of all kinds and sizes stage demonstrations, marches, 'sit-ins' and 'sleep-ins' to secure what they think are legitimate objectives… Suddenly, it is clear that there are no more 'sacred cows' in American life.[130]

Such an atmosphere had contributed to the growth of a number of "activist groups," whose "allegation of so-called 'redlining' is explosive." The bulletin reported, however, that there was an "increasing suspicion" that the "real objective" of these groups "is not merely to exert influence of lending practices," but rather the ""seizure of control of savings and loan associations as a political and financial power base." The bulletin cautioned S&Ls:

> Dealing with activist groups should not be taken lightly. Taken casually, they may mean a deterioration in customer relations, savings losses, possibly a proxy fight and erosion of the position of management. At the extreme, indifferent and apathetic response [sic] could mean heavy savings drains approaching the scale of 'runs,' and/or loss of control.[131]

The USSL urged its members to use "public relations and legal techniques" to combat the threat posed by "activist groups."

The bulletin advised associations to set up an "early warning system" for any signs of customer dissatisfaction. S&L employees, including tellers and receptionists, should report "unusual withdrawal practices" to management because they could be an instance of "so-called

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[130] William C. Prather and William B. O'Connell, "USSL: Special Management Bulletin," Dec. 30, 1974, "Mortgages Percy Wilson Mortgage & Finance Company, 1974-1975," Box 3, CAP - Dubi, Chicago History Museum.
[131] Ibid.

‘green power,’” the organized withdrawal of savings from an institution under scrutiny from “activist groups.” The USSL bulletin also provided strategies for meeting with community activists. S&L representatives should not be outnumbered by aggrieved residents at the meetings, the bulletin warned. Officers should explain that it was their “obligation” to invest savers’ money in a “careful and prudent fashion.” Officers should also note that S&Ls were “just as interested as residents in preserving the values in a particular neighborhood, particularly if its home office—representing a considerable investment—is there.” In the event of a confrontation with an activist group, the bulletin strongly advised S&Ls to conduct a vigorous media campaign. “The first rule for dealing with the media if your institution is subject to unfair attack is: BE AGGRESSIVE,” read the bulletin. Executives should “immediately” contact local media and stay in touch with them throughout the confrontation, which could last “months or years.” Too often, activist groups spoke to the media first; “rarely will an activist launch broad criticism of financial institutions without first trying to enlist media support.”[132]

Race and Family

In its short but eventful history, CAP provided a powerful, structural critique of the home finance industry. Like many other homeowner groups of the postwar era, CAP capitalized on a sense of white victimhood. Unlike many of these groups, however, CAP directed white homeowner anger not towards African Americans or attempts at racial integration. According to CAP, the victimizers were not African Americans who sought homes in white neighborhoods. Racial integration in itself was not the cause of neighborhood decline. Instead, the villains were realtors,

[132] Ibid.

S&L executives, corporate leaders, and politicians. The men that controlled the home finance and housing industries, both in government and private institutions, reaped immense personal gains in wealth and power. They made the decisions on where and to whom to lend. But redlining was more than the product of individual bankers or government officials. In fact, activists argued, the home finance and housing industries systematically benefited wealthy and suburban areas while disadvantaging lower class urban communities.

In expanding the definition of “redlining” to include wide swaths of the city’s working-class neighborhoods, activists exposed the way in which financial institutions and government policy systematically disadvantaged less affluent neighborhoods. In its attempts to appeal to the white working class, CAP was often silent on the way race shaped the housing market. CAP’s colorblind rhetoric capitalized on a sense among lower-middle-class whites that the New Deal home finance system, a system that had guaranteed them low-cost, low-risk mortgages through a locally owned financial institution, was quickly disappearing. Activists saw the disappearance of local financial institutions, especially S&Ls, as part of a larger abandonment of their communities by the corporate and political elite. The S&L down the street closing up and moving to the suburbs was, in many ways, just as important as the industrial plant doing the same. CAP appealed to nostalgia among middle-class whites for the early postwar era. To white activists, it seemed, the communitarian principles which had governed S&Ls since their early history were quickly disappearing. It was a powerful argument in no small part because S&L executives had often expressed similar ideas about their own institutions and their histories. But it was also an argument that largely erased the history of discrimination against and segregation of African Americans and other racial minorities.

To describe their political perspective, CAP activists deployed a diverse vocabulary, one that included elements of class struggle, antiestablishmentarianism, communalism, heteronormativity, and homeowner rights. Overt references to race were largely absent from this vocabulary, but the categories that it relied on were inescapably racialized. Indeed, when activists claimed that their neighborhoods were in fact not risky investments for S&Ls, or that they were not "deteriorating"—at least not until after lenders redlined them and years of disinvestment took its toll—they appealed to racialized conceptions of "decline" and "deterioration." White Chicagoans most often understood these places to be African-American communities on the South and West Sides. Similarly, when white activists spoke of "our neighborhoods" and "our money," they tapped into a sense of white homeowner privilege that extended beyond the home and into the surrounding area. When they argued that redlining made it difficult for "self-respecting" prospective residents, especially "young families," they not only expressed their desire for a heteronormative community of heterosexual couples with children—a male breadwinner and a female homemaker. They also used rhetoric laced with racialized categories, particularly in the implied comparison to those that deviated from traditional gender and sexual norms. CAP's colorblindness prevented activists from directly confronting the racial baggage that these terms carried. Without an explicit acknowledge of racism's power, activists, willingly or not, helped to naturalize the racial disparities that marked the metropolitan landscape. In the decades that followed, a colorblind discourse surrounding home finance, particularly the growth of the subprime market, would obscure the systematic disadvantaging of African-American and Latino homeowners.[133]

[133] For more on colorblind discourse, see Matthew Lassiter, *The Silent Majority*..

Indeed, in all of the flyers, speeches, and interviews that CAP produced, race was rarely mentioned. The major exception to this silence was when leaders touted the organization's cross-racial alliances, as when Mary Lou Wolff, speaking at the 1974 CAP convention, addressed the "clowns in City Hall: 'you divide and weaken us by keeping black and white apart. You can't do it anymore. Look here in this room, there are hundreds of black people and hundreds of white people united for a common cause.'"[134] And Wolff was correct: despite the organization's colorblind rhetoric, its majority-white membership, and its white-dominated leadership, white and black activists were able to find common ground within the organization. Its secretary, Hazel Montgomery, was testament to this fact. For its black members, CAP offered a chance to build alliances and achieve equal access to homeownership even if it meant appealing to whites through a colorblind class and communal solidarity. Yet white and black activists no doubt approached the issue of redlining from radically different perspectives. While black activists in the late 1960s and early 1970s saw their campaign for housing as part of a long, progressive struggle towards racial justice, white activists were motivated by a newfound sense of loss and decline. While white activists expressed nostalgia for the early postwar era, African Americans were of course not interested in turning back the clock.

Black leaders did see value in the ostensible ideals and institutional forms of the postwar home finance system, however. Black civil rights leaders and businessmen organized several black-owned financial institutions, including three S&Ls, on the Southside during the postwar era. These institutions provided millions of dollars of loans in the area. Yet these black-owned institutions and the few white-owned institutions that did business in the area still could not satisfy the demand for financial services in the black community. Many blacks who could afford

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[134] "Launch Save the City Campaign," CAP *Action*, Apr. 1974, "CAP Action Newsletter April 1971 - Winter 1975," Box 6, CAP - Booth, Chicago History Museum.

to have a bank account traveled to downtown institutions for banking. For middle-class African Americans, integration represented perhaps the best opportunity for achieving stable homeownership and gaining access to better public and private services such as schools, police, and banks. For whatever problems integrating neighborhoods faced in terms of economic instability and the risk of disinvestment, they still provided better housing, better services, and less risk for their residents than segregated communities on the south and west sides. Towards this end, white activists in CAP were important allies.

The ability of CAP to reach across racial boundaries and unite around class identity heavily depended upon a shared desire for a community of heteronormative, male-breadwinner families. In significant ways, CAP's women activists challenged traditional gender norms. Women outnumbered men in CAP and served as their most prominent leaders. Through their activism, they asserted the political rights of women and challenged the male domination of financial and political power structures. And in doing so, they demonstrated a commitment to goals shared by feminists. Most often, though, women in CAP and NPAH did not identify themselves as feminists, or "Women's Libbers," or see their groups as part of the feminist movement—at least not publicly in their roles as organization leaders. A desire for a community of "young families" was at the center of their campaign, and black and white activists were able to bridge racial divides at least partially through shared ideas about family structure and the relationship between family and community. The heteronormative male-breadwinner family linked the individual to the larger community and its institutions, including banks and S&Ls. As the bond between financial institutions and their communities weakened, activists, black and white, feared that familial bonds were in jeopardy as well.

Conclusion

Despite the victories of CAP and the seriousness with which financial executives viewed confrontation with such community groups, the suburbanization of Chicago's banking resources continued apace in 1975 and 1976. In May 1976, the Metropolitan Area Housing Alliance (MAHA), an organization with close ties to NPAH, released a study of lending data from thirty-four S&Ls and sixty-nine banks located in the city. Based on the data, MAHA estimated that 77 percent of outstanding home loans held by downtown institutions and 64 percent of those held by "neighborhood-based" lenders were for homes located in the suburbs.

CAP, along with its Greenlining Program, began to disintegrate in late 1975. The early optimism of the program dissipated as it failed to achieve the lofty goals activists had outlined. Despite countless hours of work and millions of dollars pledged, the program was unable to seriously challenge the banks and S&Ls. Part of the problem was translating pledges into actual withdrawals. But more than anything, the direct action program failed because it simply could not raise enough money. Even in the case of small S&Ls, activists had to mobilize huge sums of money from a significant proportion of the community. And as the industry rapidly consolidated, the required sums only grew. The short, if eventful, history of CAP stands in contrast to Gale Cincotta's NPAH, which continues to operate a national network of chapters. Whereas CAP chose to emphasize direct action through its Greenlining Program, NPAH and MAHA chose to focus on legislative action. While CAP's direct action program proved difficult to sustain, NPAH achieved major legislative successes in the form of the Home Mortgage Disclosure Act (HMDA) and Community Reinvestment Act (CRA).

The HMDA and the CRA were significant achievements, especially given their grassroots origins on Chicago's Westside, and they have certainly have pushed financial institutions to invest more in low-income communities than they would have done otherwise.[135] Neither act, however, succeeded in stemming the tide of urban disinvestment. Policymakers designed the HMDA and the CRA to address urban disinvestment within the New Deal Home Finance System. Thus, as the Securitized System grew and eventually replaced the New Deal System, the HMDA and the CRA became less effective. Both acts only covered depository institutions, which had been the backbone of the New Deal System, but which were now losing ground to the GSEs, which were excluded from the HMDA and the CRA. A 1977 report by the FDIC noted that such exclusions could significantly diminish the usefulness of HMDA in tracking community credit flows and potentially produce information that was "misleading."[136] Furthermore, lax enforcement reduced the efficacy of the HMDA and the CRA. Neither act enumerated specific goals in terms of local lending, and federal agencies rarely penalized financial institutions for failing to provide adequate local investment.[137] Thus, as Daniel Immergluck has argued these policies' impact has been "positive but far below their potential."[138]

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[135] For more on the HMDA and the CRA see Gregory D. Squires, ed., *From Redlining to Reinvestment: Community Responses to Urban Disinvestment* (Philadelphia: Temple University Press, 1992); Daniel Immergluck, *Credit to the Community: Community Reinvestment and Fair Lending Policy in the United States* (Armonk, N.Y.: M.E. Sharpe, 2004; Mara Sidney, *Unfair Housing: How National Policy Shapes Community Action* (Lawrence: University of Kansas Press, 2003).

[136] *Community Credit Needs: Hearings Before the Subcommittee on Financial Institutions Supervision, Regulation and Insurance of the Committee on Banking, Finance and Urban Affairs, House of Representatives,* 95th Cong. 143 (Jul. 26, 1978) (statement of George L. LeMaistre, chairman, FDIC).

[137] Squires, ed., *From Redlining to Reinvestment*; Sidney, *Unfair Housing*.

[138] Immergluck, *Credit to the Community*, 4. In addition to the exclusion of the GSEs and lax enforcement, incomplete reporting has become a growing problem for evaluating HMDA data during the past two decades. During the 1990s, it became increasingly common for financial institutions to fail to provide the race of the borrower. After "white," "information not provided" was the largest racial-ethnic group reported in 2000 HMDA

Neither CAP nor NPAH could halt the breakdown of the New Deal home finance system. The organization's critique of urban disinvestment was grounded in the New Deal system's promise of stable homeownership and community financial institutions. Organizations such as CAP drew attention to the suburbanization of mortgage capital. But the ground was shifting under their feet. As barriers to branching and consolidation fell and securitization grew, the local bonds of mortgage financing disintegrated and the call to restore a commitment to localism lost its efficacy. Within a decade of the CRA's passage in 1977, the S&L industry would be left in tatters, and mortgage securitization, facilitated by Fannie Mae and Freddie Mac, would be on the verge of becoming the dominant mode of home finance. The simple calculus of urban savings accounts financing suburban mortgages would be replaced by a much more complicated and dispersed financial network. This new system produced a landscape where capital did not just move from place to place, from Chicago's Austin to suburban Oak Park, for instance. The new financial landscape would instead be defined by ceaseless capital mobility across not just municipal boundaries but also state and national boundaries. In the new system, grassroots organizations could effectively organize protest against financial institutions around issues of consumer rights, but they lost their ability to demand that community financial institutions fulfill their local obligations. Meanwhile, consolidation, branching, and the rise of securitization eroded the expectation that money invested in the bank down the street would, or should, finance neighborhood mortgages. Increasingly, banking relationships became individualized consumer relationships rather than communal relationships grounded in place and extended over time.

data. As Elvin Wyly and Steven Holloway have argued, this silence constitutes "an erosion of the basic infrastructure for monitoring and challenging racial inequalities in housing finance." Elvin K. Wyly and Steven R. Holloway, "The Disappearance of Race in Mortgage Lending," *Economic Geography* 78:2 (Apr. 2002), 130.

Part 3

Securitization

Chapter 5

Redlining and the Rise of Mortgage Securitization

During the 1970s, the secondary mortgage market grew dramatically, and in the 1980s, it grew even faster. By the end of the decade, the secondary market had replaced thrifts as the dominant source of mortgage money. Throughout this period, Fannie Mae and Freddie Mac were the largest and most significant actors in the secondary market. They bought millions of dollars of mortgages from banks, S&Ls, and mortgage companies, aggregated them into vast pools that contained mortgages from across the country, and then sold bonds and securities based on these pools to a wide range of investors. The two "government-sponsored enterprises" (GSEs) attained increasing power to shape not only the secondary market but also the primary market in mortgages. Their decisions about where and to whom to lend helped determine the cost and availability of mortgages in cities and suburbs throughout the country.

It was a new era of extreme capital mobility. As the architects of the 1968 Housing Act intended, the GSEs purchased mortgages from institutions in high-growth regions and sold securities or bonds based on these mortgages to financial institutions in slow-growth regions. Policymakers believed that this regional redistribution of mortgage capital would direct money to where demand was highest. Powerful homebuilding and home finance lobbies from Sun Belt states helped to promote this view. Many policymakers, like Raymond Lapin, were themselves former finance executives from Sun Belt states. The GSE's purchasing policies contributed to widely divergent growth trends, fueling massive housing booms in far-flung suburbs, particularly in the Sun Belt, while draining financial resources from the urban core, particularly in northern and midwestern cities. Before the growth of the secondary market, thrifts used urban savings accounts to finance suburban mortgages (with increasing frequency in the late Sixties and early Seventies). Interregional capital mobility did occur within the New Deal System but was limited by regulation. With the growth of the secondary market, capital moved much more easily across regional boundaries. In effect, urban depositors in cities such as Chicago and New York were financing the growth of cities such as Los Angeles, Houston, and Atlanta. Indeed, during the 1970s, Fannie and Freddie facilitated a massive redistribution of mortgage capital from northern and midwestern cities to southern and western metropolitan areas. Whereas the New Deal System redlined on an intra-metropolitan scale, the securitized system redlined on an inter-metropolitan scale.

The GSEs had a profound effect on the size and shape of suburban growth, especially in the Sun Belt. In stimulating housing booms in places like Southern California and Texas, the GSEs provided vast new sums of capital that allowed developers to capitalize on economies of scale. Homebuilders raced to take advantage of the influx of mortgage capital and the increasing demand for mortgages in growing metropolitan areas in the Sun Belt such as Atlanta, Washington, DC, and Houston and, to a lesser extent, growing suburbs on the periphery of northern cities such as Detroit and Philadelphia. The result was large-scale, speculative homebuilding. Ever-larger subdivisions, encompassing hundreds of acres, sprung up on the metropolitan periphery—where builders could purchase and develop large tracts of land at low cost. Economies of scale also incentivized the stylistic and socio-economic homogeneity of these subdivisions. GSE appraisal and purchasing policies also favored such large-scale suburban developments. In order to easily securitize mortgages, they sought more uniform appraisal criteria that could transform the specificities of an individual mortgage in a particular neighborhood into a commoditized financial instrument that could be purchased by an investor without any knowledge of local real estate markets. Their criteria favored neighborhood homogeneity in style, price and age. Furthermore, the GSEs could most efficiently securitize mortgages by purchasing them in bulk, which gave preference to large-scale developments.

GSE policies also helped to shape new patterns of racial discrimination and segregation in the housing market. Like the early postwar system, the new system denied equitable access to mortgages for African Americans and Latinos in the urban core. But it also discouraged investment in racially diverse inner-suburbs in favor of newer suburbs on the metropolitan periphery. The growth of the secondary market left behind urban and inner-suburban areas, especially in the North and Midwest, compounding and broadening patterns of urban disinvestment that had begun decades earlier. Meanwhile, particularly in the southern and western metro areas that received the most GSE investment, Fannie and Freddie helped to provide increased—though still limited—opportunities for black and Latino suburbanization. Yet GSE policies—along with endemic racism in the real estate and home finance industries—created a highly segregated suburban landscape. The color lines were sometimes fuzzier and somewhat more permeable than during the early postwar era. Instead, suburban segregation followed broader patterns, with wide swaths of the metropolitan periphery (Houston's eastern suburbs, for example) becoming home to black and Latino suburbs while white suburbanization followed opposite vectors from the central city. Mortgage financing was less accessible and costlier in black and Latino suburbs, which were also usually located on less desirable tracts of land.

In the mid- and late 1970s, community activists like Chicago's Gale Cincotta challenged the GSEs' discrimination against racially diverse neighborhoods in the urban core and inner suburbs. Their allies included members of the Carter administration, most importantly HUD Secretary Patricia Harris, and Congressional liberals, such as Senator William Proxmire. Cincotta and her allies had recently won major victories in the form of the Community Reinvestment Act ("CRA") and the Home Mortgage Disclosure Act ("HMDA"). But these reforms were designed for a home finance system that was quickly disappearing. Their regulations were aimed at the S&Ls and banks that had provided the dominant source of home finance since the New Deal. By the late 1970s the GSEs were replacing these institutions as the most important actors in the mortgage market. Activists and policymakers concerned about mortgage availability in the cities realized that GSE reform was vital to stemming urban disinvestment. Congressional hearings held by Senator Proxmire in 1976 and 1977 attempted to highlight the GSEs' suburban bias and force them to invest more money in lower-class urban neighborhoods.

The GSEs, armed with increasing lobbying power within Congress, were able to defeat the reformers' agenda. One exception was a new set of lending "goals" issued by Secretary Harris that required 30 percent of GSE mortgages to be urban and 30 percent to be low- and moderate-income. These goals sounded impressive. Yet, anything below the median home value counted as "low- and moderate-income." The GSEs could continue to direct 70 percent of their purchases to above-median mortgages. Moreover, the GSEs were able to skirt the spirit of these reforms by exploiting the definitional muddiness of what counted as “urban.” Most of the GSEs “urban” mortgages were in the Sun Belt, where liberal annexation policies had created sprawling urban municipalities. Anything within the city boundaries counted as “urban.” And when the GSEs bought mortgages in the urban core, they were often in affluent neighborhoods. Most importantly, enforcement was ineffectual. They were only “goals” and not mandates. If the GSEs failed to meet them, they would not face punishment but rather a convoluted and drawn out process of HUD examination and oversight.

Hope for more meaningful policies to reverse urban disinvestment faded quickly. The early 1980s brought with it a new political and economic calculus regarding mortgages. The New Deal interest rate ceilings on savings accounts in a time of high inflation undercut the ability of the middle class to receive adequate yields on their savings. Washington’s response was interest rate deregulation, championed by President Carter and Congressional liberals in the name of middle class “small savers.” The thrift industry, which now faced the prospect of paying market-rate returns to its savings customers, vigorously opposed the deregulation. As interest rates rose sharply, especially after Carter’s appointment of Paul Volcker to the Fed, the thrift industry was thrown into crisis. Deregulation compelled thrifts to pay more money to savers while the bulk of their income came from mortgages locked into the lower interest rates of previous years. Consequently, thrifts had less money to lend for new mortgages and the nation entered the worst housing slump since the Great Depression.

As thrifts declined, the GSEs grew—helped along by a growing consensus in Washington that the secondary market would need to replace the ailing thrift industry as the most important source of home financing. With middle-class homeownership under threat, the attention of liberal policymakers shifted their focus away from the issues of financial equity raised during the 1976-77 Senate hearings. Instead, their attention turned to the effect of inflation on middle-class homebuyers and financial consumers—President Carter's "small savers."[1] Policymakers were increasingly inclined to support Fannie, Freddie and the secondary market in general in order to maintain mortgaged homeownership for the middle-class as a central policy objective. Preserving this goal overshadowed criticism of the GSEs' lending policies and obscured the centrality of the secondary market to the growth of Sun Belt suburbs.

This chapter is intended as a broad overview, rather than an exhaustive analysis, of the federal policy debates surrounding mortgage policy during the period. It also uses data made available by these debates to illustrate the extent to which the GSEs favored large-scale, planned developments on the metropolitan periphery, particularly in the Sun Belt. It concludes with a description of the policymakers' wholehearted embrace of the secondary market in the early 1980s. Most importantly, it sets the stage for the following chapter's case study of Houston. That chapter will explore the changing political economy of mortgages on a local level with special attention to the way class and race shaped differing experiences of the new home finance system. It will illustrate what types of suburban developments benefited most from securitization and how the new system made mortgaged homeownership much riskier for homeowners.

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[1] Robert B Henderson, "Dream Deregulated: The Politics of U.S Housing Finance, 198-1985," PhD diss., History, University of Maryland, College Park, 2013.

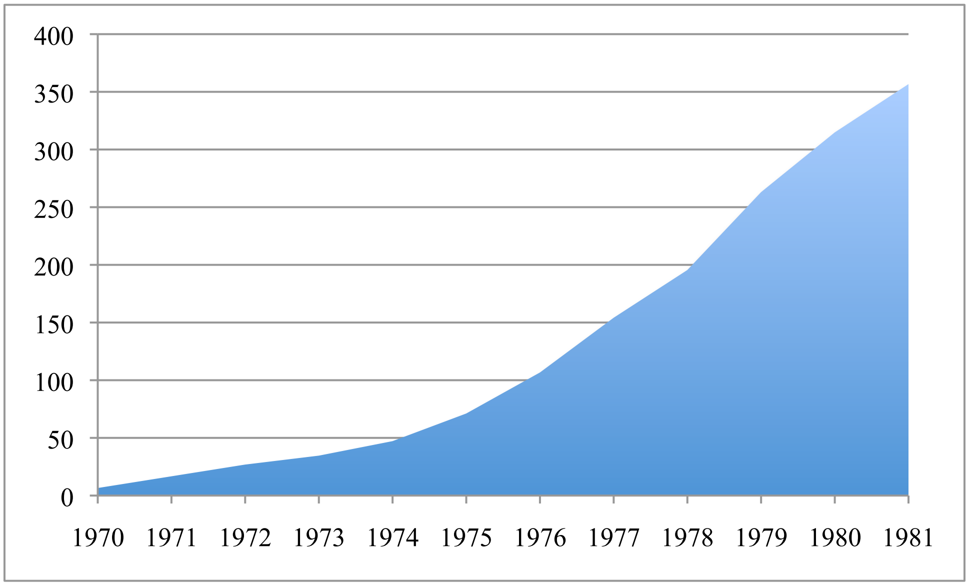

Figure 5.1. Value of Federally Underwritten Pass-Through Mortgage Securities (in US$ millions, constant 1982 dollars).
Source: The Report of the President's Commission on Housing, (Washington: 1982), 113.

Growth of the Secondary Market

The secondary mortgage market grew dramatically during the 1970s and grew even faster during the 1980s. By 1986, nearly half of all residential mortgages in the US were sold on the secondary market. Throughout this period of growth, Fannie Mae and Freddie Mac dominated the secondary market. In 1972, Fannie Mae purchased $308 million in conventional mortgages. By 1975 the number had increased to almost $2.4 billion.[2] By 1976, Fannie Mae was the second largest borrower in the US, only behind the Treasury.[3] In 1970, federal credit agencies (Fannie, Ginnie and the new Freddie) held less than six percent of all outstanding mortgage debt. This

[2] Congressional Research Service, *The Role of the Federal National Mortgage Association in the Secondary Mortgage Market*, Dec. 3, 1976, 9. All dollar amounts are in constant 2015 dollars unless otherwise noted.
[3] *Secondary Market Operations of the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation: Hearings Before the Senate Comm. on Banking, Housing and Urban Affairs*, 94th Cong. 1 (Dec. 13, 1976).

proportion more than doubled by the end of the decade. During the thrift crisis of the 1980s, the proportion grew even faster, reaching nearly forty percent by 1988.[4]

In 1971, Freddie Mac unveiled its Mortgage Participation Certificate (PC) program. The PCs were securities that represented undivided interest in pools of the corporation's conventional mortgages. Interest and principal payments were passed through to the investors as they were collected on a monthly basis and were guaranteed by Freddie. If homeowners paid their principal early, these payments would also pass through. Early payments meant that investors could lose out on future interest, a fact that made PCs less attractive for institutional investors that wanted a guaranteed yield. Thrift institutions were the primary purchasers of PCs. Because payments were passed through as they were received, PCs were considered to be the same as mortgages for accounting, tax and regulatory purposes, meaning that thrift institutions, which were largely restricted to mortgage investment, could purchase them.

The primary goals of the PC program, according to the corporation's president, was to redistribute mortgage money among thrift institutions from capital rich to capital short regions (for example, from Chicago to Houston).[5] In 1972, the first year of its operation, the program sold nearly half $2.8 billion in PCs to investors (primarily S&Ls). In 1974, during a period of credit stringency, Freddie Mac only sold $240 million dollars in PCs, reflecting the capital shortage among S&Ls, its prime customers for mortgage sales. But in 1975 and 1976, the program rebounded. Through the first eleven months of 1976, Freddie sold $5 billion in PCs.[6] In

[4] Howard L. Roth, "Volatile Mortgage Rates—A New Fact of Life," *Federal Reserve Bank of Kansas City Economic Review* (Mar. 1988), 22.
[5] *Secondary Market Operations of the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation: Hearings Before the Senate Comm. on Banking, Housing and Urban Affairs*, 94th Cong. 324 (Dec. 13, 1976).
[6] Ibid., 326.

1976, PCs were issued in minimum denominations of one hundred thousand dollars (with a maximum of one million dollars).

In 1975, Freddie Mac issued its first Guaranteed Mortgage Certificate (GMC). The GMC was designed to attract institutional investors that would usually not invest in mortgages. The corporation sold $2.2 billion in GMCs in 1975.[7] GMCs were designed to be "as bond-like as possible" in order to attract investors unfamiliar in mortgages. Unlike PCs, interest and principal payments were not passed through as they were received but instead were made semiannually and annually, respectively. They were also freely transferable without fee, meaning that investors could easily buy and sell them. And, Freddie would repurchase any remaining unpaid principal when the certificate reached maturity, usually fifteen or twenty years.

Freddie Mac saw the PC and GMC programs as progressive steps toward a "true" secondary mortgage market, specifically one dominated by mortgage-backed securities rather than one dominated by the trading of individual mortgages. The PC and then the GMC were important innovations but the corporation saw as its mission to develop financial instruments that would be even more attractive to investors.[8]

During the early 1970s, Freddie increasingly shifted towards conventional mortgage purchases. In 1972, it bought $4.7 billion in FHA/VA mortgages and $2.6 billion in conventional mortgages. In 1975, it bought $520 million in FHA/VA mortgages and $7 billion in conventional mortgages.[9] The Congressional Research Service ("CRS") report stated that this early focus on FHA/VA mortgages was due to their "greater standardization" at the time.[10] As GSEs achieved

[7] Ibid., 326.
[8] Ibid., 364.
[9] Ibid., 358.
[10] Ibid., 645.

greater standardization in the conventional market, they increased their purchases of conventional mortgages.

During the 1970s, Fannie Mae financed its mortgage purchases by selling debt securities. Unlike Freddie Mac's pooling techniques, these securities were based on Fannie's entire portfolio. Commercial banks were the most prominent customers for these securities, holding more than 60 percent in 1976, with a variety of other entities (such as thrifts, corporations, state and local governments, and pension funds) making up the rest.[11]

Fannie and Freddie Under Attack

In 1960, fresh out of college at UC Berkeley, Lorraine Legg got a temporary job at Raymond Lapin's Bankers Mortgage Company in San Francisco. After impressing company executives with a research project, Bankers Mortgage offered Legg a permanent position. Legg debated the offer. She was a young idealist, "imbued with the idea of doing a lot of social good," she told the *Washington Post* in 1969. She "had the classic definition—of going out on the streets and helping people—in mind." But Lapin convinced her to stay. "Mr. Lapin," she said, "persuaded me that people in the mortgage business were not fellows with black capes and mustached lips, and that there was room for public service in it." Legg rose fast. She became the director of credit analyses, then loan processing and investor sales. In 1967, she followed Lapin to Fannie Mae as his special assistant. There, she helped lobby Congress for Title VII of the 1968 Housing Act, which privatized Fannie Mae and opened the door to mortgage securitization. Her success in dealing with Congress, where she demonstrated an intricate and expansive knowledge of mortgage markets, led to her appointment as vice-president for corporate relations in 1969. She was only twenty-nine years old and her idealism had not faded. Fannie Mae, she thought, would

[11] Ibid., 732.

help provide homeownership opportunities for millions of families that would have never gotten a chance otherwise. *The Washington Post* expressed surprise at her prominent role at an organization “which on the surface seemed no place for a girl.” The newspaper dubbed her the “lady among the mortgages.”[12]

By 1976, Legg’s optimistic view of Fannie Mae had been upended. “Stripped of all of the elaborate rhetoric,” she testified before the Senate Committee on Banking, Housing and Urban Affairs, “FNMA engages in red-lining, thereby accelerating the flight to the suburbs.”[13] By that time, Legg was no longer at Fannie Mae. She had left after the Nixon administration forced her mentor, Raymond Lapin, to resign as Fannie Mae president in 1969. She was not an activist—she was now vice-president of a Boise real estate company—but her testimony was among the most damning and most thorough of Fannie’s critics. In a lengthy written statement, which included hand-drawn charts, detailed statistics, and an exhaustive history of mortgage lending, Legg claimed that Fannie had neglected its mandate of providing low and moderate income housing in favor of upper-class, suburban developments. According to her, the association’s attitude had been "let's have all the benefits of government backing and none of the responsibilities.”[14] The association, she stated, had “abandoned the cities and small towns and now competes with other institutions in the suburbs rather than complementing the activities of those institutions.” Legg did not deny that Fannie Mae owed its stockholders a fair return on their investment, but “American taxpayers are also entitled to a return on their investment.” The GSE, she said, had failed to fulfill the goals of the 1968 Housing Act, a piece of legislation that

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[12] “Lady among the Mortgages,” *Washington Post*, Feb 16, 1969.
[13] *Secondary Market Operations of the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation: Hearings Before the Senate Comm. on Banking, Housing and Urban Affairs*, 94th Cong. 76 (Dec. 13, 1976).
[14] Ibid., 65.

she herself had been instrumental in passing. Instead of saving the cities, as she and the Johnson Administration had promised in 1968, "urban blight and the flight to the suburbs has accelerated."[15]

As a former insider and proselytizer for the secondary mortgage market, Legg provided a unique and powerful account of Fannie Mae's pro-suburban bias, but she was not alone. Legg submitted her damning statement at a hearing convened by Senator William Proxmire—the first oversight hearing for Fannie Mae and Freddie Mac since the 1968 Housing Act had partially privatized the former and the 1970 Emergency Home Finance Act had created the latter. Proxmire's hearing provided the first national forum for criticism of GSE lending policies. A year later, Senator Proxmire would hold another hearing on Fannie Mae at which new HUD Secretary Patricia Harris would join a number of community activists in protesting the association's lending policies. These witnesses strongly criticized Fannie Mae for favoring suburban development and contributing to urban disinvestment. According to them, Fannie Mae was redlining low-income, racially diverse, urban communities. The mortgage association might have deployed more complicated and less overt methods than in the past, but it was redlining all the same.

The 1976 hearing also produced two CRS reports on the GSEs that offered the most detailed public data available concerning GSE lending policies. They were a rare glimpse into the operations of Fannie and Freddie. The complexity and secrecy surrounding the secondary mortgage market obscured the specific ways in which it redistributed mortgage funds. More often than not, homeowners were unaware that their mortgage had been sold on the secondary market as the institution that originated their mortgage continued to service it. Furthermore, Fannie and Freddie were, and are, exempt from FOIA and they vigorously protected their right to

[15] Ibid., 66.

corporate privacy as privately owned, profit-seeking businesses. For activists and scholars, it was (and continues to be) difficult to obtain detailed, consistently published data on Fannie and Freddie operations. Thus, the two hearings along with the CRS reports are key to understanding how the GSEs shaped the mortgage market.

In addition to Legg, the 1976 hearing featured testimony from Darel Grothaus, director of Seattle's Department of Community Development. Grothaus provided a detailed analysis of GSE appraisal criteria that, he said, "appear to be giving public sanction to lending policies that redline older neighborhoods."[16] He argued that the growth of the secondary market brought with it "the increasingly universal" application of appraisal standards that disadvantaged older, racially and economically diverse urban neighborhoods. Even when lenders did not immediately sell their mortgages on the secondary market, he noted, they wished to preserve this option. So they applied the same, universal criteria on all loans they made. These guidelines, Grothaus argued, "penalized neighborhoods because of the economic diversity of their residents and because of current or prospective concentrations of racial and ethnic minorities." The result was that "new housing construction in older neighborhoods is thwarted."[17]

Fannie and Freddie denied their participation in redlining, claiming that they were only acting in accordance with their charter legislation. The statutory guidelines that established Fannie and Freddie stated that their purchases be determined by "standards imposed by private institutional mortgage investors." Private standards were largely shaped by the two main industry groups representing real estate appraisers, the American Institute of Real Estate Appraisers (AIREA) and the Society of Real Estate Appraisers (SREA). Fannie Mae and Freddie Mac based

[16] Ibid., 49.
[17] Ibid., 40.

their appraisal criteria on those of the AIREA and the SREA, and the FHLBB required its members to use the appraisal standards of the AIREA and the SREA.

As Grothaus pointed out, both the AIREA and the SREA codified the assumption that neighborhood values would decline with age and placed value on the social and economic homogeneity of a neighborhood. Both organizations claimed that neighborhoods lived out a natural "life cycle," an inevitable set of phases governed by inherent laws of the market. In its guidelines, the AIREA told its members that "neighborhoods pass through life stages similar to the life cycle of all nature: integration, equilibrium, and disintegration." The SREA used similar language, though its life cycle did allow for the possible "renewal and rehabilitation" of some neighborhoods. Examples included the gentrifying neighborhoods of Old Town in Chicago and Society Hill in Philadelphia. The "natural" decline of all neighborhoods resulted from the "attractions…of new competitive areas," the increasing "functional obsolescence" of the neighborhood's properties, and the encroachment of "new uses," according to the SREA. The AIREA was somewhat more explicit: "Because of infiltration of lower user groups, inharmonious land uses, and/or greater appeal of newer and more attractive houses elsewhere, properties decline in desirability and value."[18]

The SREA and the AIREA language on neighborhood homogeneity was also strikingly similar to earlier HOLC and FHA guidelines, minus explicit references to race. The absence of explicit reference to race notwithstanding, the guidelines simply could not reasonably be applied in a color-blind manner. The AIREA determined that "maximum value is realized when a reasonable degree of sociological and economic homogeneity is present." The SREA enumerated eight criteria in determining a neighborhood's homogeneity, including the age, "style," and price of homes and also the residents' income and "cultural, ethnic and social backgrounds." Even

[18] Ibid., 36-38.

though race was not mentioned, "ethnicity" was a near-explicit reference to race. Few appraisers would have understood black, Latino, and other racial minorities as sharing similar "cultural, ethnic and social backgrounds" with white Anglo Americans.[19]

GSE guidelines were not as explicit or detailed in their preference for newer and socio-economically homogeneous neighborhoods but they implied the same assumptions. Moreover, they frequently stated their reliance on private appraisal standards and drew from the same professional pool as private groups. GSE appraisers could thus easily read between the lines, applying similar metrics for neighborhood value and risk whether working for Fannie or a local financial institution.

Grothaus cited GSE appraisal criteria that reflected the assumption, similar to the private appraisal standards, that neighborhoods almost always deteriorated in value with age. Appraisers estimated "the remaining economic life" of the property based on the age of the neighborhood's housing stock, its social and economic characteristics, land use patterns, and the degree that surrounding land had been developed.[20] "No matter how good an individual property is, it alone cannot overcome generally prevailing economic obsolescence in a neighborhood," Freddie Mac guidelines warned. In the case that "the sum of the age of the property plus the term of the loan exceed 60 years," the guidelines stated, "the property should be considered for inspection prior to purchase by FHLMC."[21] In other words, a typical thirty-year mortgage on a home older than thirty years received heightened scrutiny from Freddie Mac—something lenders would wish to avoid wherever possible.

[19] Ibid.
[20] Ibid,, 43.
[21] Ibid., 44. Because of pressure from Congress, Freddie Mac removed this requirement in 1976.

Similarly, Fannie Mae and Freddie Mac valued social and economic homogeneity, especially in terms of the age and price of the homes in a given neighborhood. GSE appraisers noted the homogeneity of the neighborhood's property values, type of occupancy (owner vs. renter), architectural style, land use and the age of the buildings. Properties that did not "conform" to their surrounding neighborhoods were considered to be higher risk and subject to inspection. Freddie Mac considered new or "over-improved" homes in older neighborhoods as questionable investments. "A property which falls out of the general age group should receive special consideration," Freddie Mac guidelines stated.[22]

Both Fannie and Freddie claimed that they did not discriminate based on race. But in their reliance on prevailing "market standards," the GSEs embraced "economically-based" policies freighted with racially discriminatory effects. Freddie Mac's guidelines were illustrative: "a standard which has a discriminatory effect is not necessarily improper if its use achieves a sound business purpose which cannot be achieved by means which are not discriminatory in effect or less discriminatory in effect."[23] Racial discrimination was a profitable business so it would be easy to defend it as being financially sound. And the second threshold—whether there were alternatives that mitigated the racially discriminatory effects —was highly subjective. It would be extremely difficult for victims of racial discrimination to prove that the GSEs had other ways to achieve the same level of profits.

Grothaus urged Congress to require that the GSEs abandon their discriminatory guidelines and adopt a proactive policy of urban reinvestment. Importantly, Grothaus argued that a fairer housing policy could only be achieved with the involvement of local residents, public officials and lenders. "It is ironic," he noted, "that most lenders do not consult persons who are

[22] Ibid., 44-45.
[23] Ibid., 43.

most knowledgeable about neighborhood conditions—local residents." The growth of the secondary market and its appraisal standards had led to "a loss of sensitivity to the particular needs, opportunities and problems of individual neighborhoods."[24]

The GSE forward commitment system that favored new, large-scale suburban developments represented a new and more expansive form of redlining, national in scope. Fannie and Freddie purchased most of their conventional mortgages through the "forward commitment" system, whereby they agreed in advance to buy mortgages that were not yet originated. Almost always, these purchases were done in bulk. With a commitment in hand, mortgage companies, S&Ls and banks were able to offer homebuilders financing for vast new subdivisions, favoring outlying suburbs where developers could build large, new tracts of single-family homes on a scale that could not be matched in already-existing urban and inner-suburban neighborhoods.

Buying in bulk through the forward commitment system allowed the GSEs to quickly execute transactions involving millions in mortgage dollars over vast distances with low overhead costs. In 1985, Rep. Harry Barlettt, who hailed from Dallas's quickly growing northeast suburbs, praised the efficiency of Freddie Mac's operations. He described his tour of the corporation's facilities:

> There's a small room in Freddie Mac's basement where a staff of not more than six or seven talk to lenders all over the country to let them know what prices Freddie Mac can buy mortgages for each day. This staff also commits Freddie Mac to buy the mortgages that lenders want to sell… approximately 3 hours and 100 calls later, a tape of all the transactions for that day are taken by a messenger from the commitment room to the trading room 3 floors up. The traders there call 15 Wall Street firms simultaneously and the firms bid on the mortgages Freddie Mac has committed to purchase that day.[25]

[24] Ibid., 49.
[25] 131 Cong. Rec. H E3460 (July 23, 1985).

The forward commitment system, along with GSE appraisal criteria, helped to shape the size and homogeneity of the new suburbs built during the 1970s and 1980s. In Houston, the GSE-fueled housing boom produced huge, master-planned communities often encompassing hundreds of acres.[26] Most of these subdivisions were on the metropolitan fringe where developers could acquire vast tracts of land on a relatively cheap basis. In 1978, the fastest growth was on Houston's far northwest side, which alone accounted for a quarter of the area's new detached, single-family homes.[27] Master planning on a large scale helped to achieve the socio-economic and architectural homogeneity that the GSEs demanded. Often, individual subdivisions were part of a larger development. Each subdivision was delineated by home price and architectural style. In its annual report, for instance, the Friendswood Development Corporation, which was a subsidiary of Exxon, described its vast communities as a series of "small villages… each with its own identity, and it is this identity which has so much sociological significance."[28] Such a landscape, the company said, offered residents the "orderliness" that older, urban neighborhoods lacked.

Mortgages and the "Free Market"

Under the early postwar system, financial institutions had responded to claims of redlining by arguing that their decisions were a product of market logic. But with the growth of the secondary market, these institutions responded not to some private "market logic" but rather to market norms set by Fannie Mae and Freddie Mac. Financial institutions increasingly made decisions about where to lend based on fulfilling the criteria used by the GSEs. As Freddie Mac's president

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[26] *Homeownership Task Force: Hearings Before the Subcommittee on Housing and Community Development of the Comm. on Banking, Finance and Urban Affairs, House of Rep., Part 1*, 95th Cong. 608, 651 (Jan. 24, 1978).
[27] Ibid., 597, (Statement of Michael H. Inselmann, Urban Research Corp.).
[28] Friendswood, 1974 Hi Lites, 3, Box 11, Folder 11, Y. Frank Jungman Collection, Houston Metropolitan Research Center.

noted in 1976 "regardless of the selling intentions of any particular primary lender… our underwriting standards [have] become a minimum standard of quality for mortgages generally. The term 'Mortgage Corporation quality' is becoming a designation in the market for mortgages of a particular tradeable grade."[29]

Financial executives claimed that GSE policy determined their lending decisions. For example, Alan E. Rothenberg, a vice-president at Bank of America, argued before a HUD meeting in 1976 that "if FNMA and FHLMC revised their lending criteria to show a willingness to buy urban loans, reasonably underwritten, you would see a substantial number of traditional mortgage lenders re-devoting their efforts to providing these loans to the secondary market. Many a private lender feels he cannot justify making loans in urban areas when he knows the federal government, through its credit agencies or its insurance programs, will have no part of any of these loans because they are considered too risky."[30] Rothenberg had a vested interest in displacing blame for urban disinvestment onto the GSEs, but activists like Grothaus and Cincotta cited his comments as evidence of the growing power of the GSEs to shape the flow of mortgage credit and to provide private financial institutions a convenient way to deflect criticism of their lending policies.

In the securitized system, the defense of market logic fell to the GSEs. They explained their policies as the outcome of natural market forces. But they were ill-suited defenders of the "free market." Government support was vital to their operations. Indeed, without government backing, they simply would not exist. However, few non-experts understood the importance of

[29] *Secondary Market Operations of the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation: Hearings Before the Senate Comm. on Banking, Housing and Urban Affairs*, 94th Cong. 317 (Dec. 13, 1976).
[30] Ibid., 34.

government subsidies to their operations. They were, after all, privately owned. Thus, they had a readymade answer to critiques of their policies. They had to be responsive to their owners. They had to be good businesses, seeking profit wherever possible. Yet in the supposed era of "free markets," the GSEs only increased the government's role in the housing market. They were an example of how so-called "privatization" actually deepened government intervention in the market.

Interregional Capital Mobility

The 1976 hearing, particularly the two CRS reports, shed light on the GSEs' regional preferences. Despite their claims of facilitating a truly national market, GSE financing was unevenly distributed from region to region. Metro regions in the South and West received the lion's share of GSE investment. California and Texas routinely received twice the amount of GSE financing as all the other states combined. Northeastern and Midwestern cities such as Boston, Cleveland and Pittsburgh received almost nothing from the GSEs. Virtually shut out of the booming secondary market, these cities relied on traditional primary lenders, such as banks and S&Ls, to satisfy their financing needs. Regional inequity interacted with the GSEs' suburban preferences. GSE money followed, but also drastically strengthened, widely divergent regional growth trends. In metro areas with growing suburbs—whether a result of booming industry or white migration from the urban core—GSE money intensified development on the metropolitan fringe. Regional inequity in GSE funding was thus both a cause and effect of suburban homebuilding booms.

The regional disparity in GSE financing was the product of the corporations' mandate to link regional mortgage markets together into a single national mortgage market. In classic economic terms, this made sense—the GSEs moved mortgage capital to where demand was highest (if one defines demand as homeowners' ability and willingness to pay higher rates). But for homeowners in cities left behind by the GSEs, this achievement of a national mortgage market carried with it the acceleration of a wide and crushing regional gap between winners and losers.

The early postwar system subsidized and regulated thousands of local financial institutions through government agencies like the Federal Home Loan Bank (FHLB) and the Federal Housing Administration (FHA). These institutions largely relied on local savings deposits to finance local mortgages. Transferring mortgage funds from region to region faced regulatory, cost, risk, and cultural issues.[31] Barriers to interregional capital mobility meant that mortgages in high-growth areas carried higher interest rates. Where demand for mortgages was relatively low and bank and thrift deposits were relatively high (such as New York), mortgage rates could be about a percentage point lower than in areas where the opposite was true (such as California). And during periods of disintermediation, as in 1966, mortgages were virtually unavailable in high-growth regions like California.

As the secondary market grew, mortgage rates converged across different regions, meaning that homeowners in New York and California, regardless of local demand and supply, paid about the same rate on their mortgages by the end of the 1980s.[32] Increased capital mobility was a central goal of the GSEs. Their stated objective was to transform the secondary market from a small, disparate set of local and personal relationships into a standardized, national and fluid network of capital. When asked to list its "most important functions, in order or priority,"

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31 Roth, "Volatile Mortgage Rates," 22.
32 Ibid.

Freddie Mac listed its regional redistribution of mortgage funds first, followed by its ability to attract mortgage investment from "non-traditional" sources of capital.[33] Third and fourth were, respectively, the standardization of the mortgage process and the general promotion of the secondary mortgage market.

The 1976 Congressional hearing on the secondary mortgage market, however, offered a glimpse of the regional distribution of the GSE mortgage purchases. Material submitted by the GSEs showed that their purchases were heavily concentrated in high-growth areas, particularly California and Texas but also Washington, DC, Atlanta, and Seattle. During the first three quarters of 1976, for example, four of the top ten metro areas in terms of Fannie's mortgage purchases were in California. Houston ranked second where Fannie's mortgage purchases were four times the amount of mortgages purchased in the Chicago metro area, even though it was three times the size of the Houston metro area. The contrast with New York was even starker. Fannie's New York purchases were a sixteenth of Houston's even though New York was more than six times the size of Houston.[34]

Through the late 1970s and early 1980s, Fannie Mae continued to purchase large quantities of mortgages in California and Texas. During the height of Houston's boom in the late 1970s, the association drastically increased its Houston mortgage purchases. In the second quarter of 1979, for example, Houston was the number one metro region for Fannie purchases, with Los Angeles ranked second. During the quarter, Fannie Mae purchased almost $200 million of mortgages in Houston and $167 million in Los Angeles. Together, these two metro areas

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[33] *Secondary Market Operations of the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation: Hearings Before the Senate Comm. on Banking, Housing and Urban Affairs*, 94th Cong. 347 (Dec. 13, 1976).
[34] Ibid. 447-448.

represented almost fourteen percent of all of Fannie's mortgage purchases.[35] The trend would continue with Los Angeles and Houston consistently ranking as the top metro areas for Fannie purchases during the late 1970s and early 1980s.[36] Cities such as Anaheim, San Jose, Dallas, Atlanta and Washington, DC also consistently ranked near the top during the period.

[35] "L.A. second in Fannie Mae Buy List," *Los Angeles Times*, Aug. 19, 1979.

[36] "L.A. Area, California Top Fannie Mae Buy List," *Los Angeles Times*, Nov. 4, 1979; "Fannie Mae Issues Report on Mortgage Purchases," *Los Angeles Times*, May 11, 1980; "FNMA Buys $188.6 Million in State Mortgages During Quarter," *Los Angeles Times*, Aug. 29, 1982.

Metro Area	Mortgage purchases (in $ million)
1. Washington, DC	319.25
2. Houston	287.04
3. LA/Long Beach	199.89
4. Atlanta	177.18
5. Seattle/Everett	167.68
6. San Francisco/Oakland	152.40
7. Detroit	124.31
8. Anaheim	120.60
9. Philadelphia/Camden	114.81
10. San Jose	98.29
11. Denver	88.38
12. Dallas	84.25
13. Chicago	68.15
…	
23. New York	17.76
…	
26. Cleveland	4.54
27. Pittsburgh	2.48
28. Patterson/Clifton (NJ)	2.48
29. Buffalo/Niagara	2.07
30. Boston	1.24

Figure 5.2. Fannie Mae Conventional Mortgage Purchases in Top Thirty Metro Areas, First Nine Months of 1976. *Source: Secondary Market Operations, 447-448.*

Fannie Mae's relatively large purchases in two metro regions outside the Sun Belt--Detroit and Philadelphia- are informative. These exceptions to the GSEs' Sun Belt preference served as evidence of their suburban bias. Detroit and Philadelphia saw rapid suburban growth during the 1970s as thousands of whites moved from the city to the suburbs. In both metro areas, the central city lost significant population, while the suburbs grew dramatically. This pattern was in stark contrast to other Rust Belt cities, such as Pittsburgh and Cleveland, where both city and suburbs lost population.

It was a similar story for Freddie Mac. By 1976, California and Texas mortgages made up a third of Freddie Mac's conventional mortgage portfolio. Freddie Mac also provided data on the source of its funds for its mortgage participation (PC) program. Illinois, home to the largest number of S&Ls in the country, held $693 million of Freddie mortgages, or 11.5 percent of its total holdings. New York was just behind with $680 million. Ohio, Indiana, Minnesota, Michigan, Missouri, Pennsylvania, New Jersey and Kentucky rounded out the top ten, in order. By contrast, Illinois received only 2.1 percent of Freddie's investment in conventional mortgages, New York just 0.3 percent. Together, these top ten states in terms of financing provided funding for more than two-thirds of Freddie's mortgage portfolio, while they accounted for under fourteen percent of Freddie's conventional mortgage purchases. By contrast, institutions in California and Texas together held less than six percent of Freddie's portfolio.[37]

In addition to the GSEs suburban favoritism, the regional preferences of Fannie and Freddie drew criticism. In an exchange between GSE executives and Senator Proxmire, the Senator complained: "It somehow seems California just dominates everything in this area," pointing out that while California was home to 10 percent of the nation's population, it was home to almost one quarter of the GSEs' mortgages. During the first nine months of 1976, Proxmire noted, almost 70 percent of Freddie Mac's purchases were in West Coast states. By contrast, his home state of Wisconsin, which had two percent of the nation's population, was home to just eight tenths of a percent of Fannie's mortgage portfolio.[38]

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[37] Congressional Research Service, *The Role of the Federal Home Loan Mortgage Corporation in the Secondary Mortgage Market*, Dec. 8, 1976, 11-12.

[38] *Secondary Market Operations of the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation: Hearings Before the Senate Comm. on Banking, Housing and Urban Affairs*, 94th Cong. 438 (Dec. 13, 1976).

	Net Inflow from Secondary Market (sales minus purchases) (in $ million)
Los Angeles	4,503
San Francisco	2,212
San Diego	1,639
Washington	1,186
Dallas	456
Phoenix	456
Seattle	393
Atlanta	200
Houston	114
Minneapolis	74
Boston	68
Baltimore	-63
Detroit	-174
St. Louis	-388
Pittsburgh	-396
Philadelphia	-442
Cleveland	-476
New York	-553
Miami	-949
Chicago	-1,057

Figure 5.3. Secondary Market Activity of S&Ls in 20 Largest Metropolitan Areas, 1980.
Source: Federal Home Loan Bank Board, Savings & Home Financing Source Book 1980, 33-38.

The GSEs argued that market forces outside of their control shaped their lending decisions. The interregional transfer of capital from the North and East to the South and West was a product of simple laws of supply and demand, they said. Fannie Mae's chairman, Allen Oakley Hunter, claimed that the regional imbalance was the product of a "market over which no one has control." Higher mortgage rates in high-growth areas like California promised higher returns to investors. Proxmire was unimpressed, arguing that the GSEs were "rewarding" higher interest rates and favoring California homeowners and financial institutions. Freddie Mac vice-president Philip Brinkerhoff responded brusquely, "that is the law of supply and demand. If people in other segments of the country were demanding mortgages to the same extent, our facilities are open to them the same as they are in California." Proxmire offered a pithy response: "That explanation would satisfy me completely if I were a Senator from California."[39] Brinkerhoff's claim that there was little demand for mortgages in "other segments of the country" was refuted by the testimony of Grothaus, Williamson and others. But these were not the type of mortgages that the GSEs desired. They were in older, urban communities and did not provide the same high interest rates as California or Texas mortgages.

The 1977 Hearings

In 1977, the Senate Committee on Banking, Housing and Urban Affairs held hearings to amend Fannie Mae's charter. The 1977 Fannie Mae charter amendment, sponsored by Senators William Proxmire of Wisconsin and Alan Cranston of California, both Democrats, would have added four additional presidentially appointed members to the corporation's board. It would have thus reduced the shareholder-elected board majority from ten out of fifteen to ten out of nineteen. Proxmire argued that this would increase the corporation's attention to its "public interest" mandate. There was no guarantee, however, that presidentially appointed board members would actually serve the public interest. Aside from White House politics, the charter would have maintained that three of the presidentially appointed members come from the home finance, homebuilding and real estate industries. Yet, Fannie Mae vigorously opposed the amendment, which also included an expansion of FOIA to cover the corporation.

The bill's proponents argued that it would strengthen Fannie Mae's commitment to the "public interest." They criticized the corporation for acting too much in the interests of profit

[39] Ibid., 439.

while neglecting lower- and middle-class, urban and minority mortgage needs. Fannie Mae, according to Senator Cranston, was developing an erroneous "image of itself as a normal private corporation."[40] In fact, Congress had always intended for Fannie Mae to act towards "a specific public purpose," namely achieving homeownership for all Americans. To aid the corporation, Congress granted Fannie a number of special privileges, which provided not only certain, direct advantages, for example, an exemption from SEC regulation and a backstop line of credit from the Treasury, but also the marketplace expectation that the federal government would ultimately back the corporation in a crisis. This expectation allowed the corporation to borrow money at significantly lower costs than private institutions. It was only reasonable, Proxmire and Cranston argued, that in exchange for these privileges Fannie Mae should be responsive to the public interest. Their bill, they said, would reinforce "public representation" in Fannie Mae's decision-making.

HUD Secretary Patricia Harris voiced strong support for the bill. Most of Fannie Mae's purchases were in affluent, white suburbs. Few were in lower-class, urban and minority neighborhoods. Fannie Mae, she argued, held the power to reverse patterns of urban disinvestment by purchasing more mortgages for lower-class, urban, minority residents, which would prompt other financial institutions to increase significantly their own investments in those urban mortgages. Fannie Mae had not done enough to ease periodic mortgage shortages, a mandate aspect of its charter, according to Harris. Fulfilling this mission not only necessitated purchasing mortgages when the market was tight but also selling mortgages when the market was loose. Selling mortgages would help build up liquidity and thus allow the corporation to

[40] *Federal National Mortgage Association Charter Act: Hearings Before the Sen. Comm. on Banking, Housing and Urban Affairs,* 95th Cong. 8 (Jun. 7, 1977).

purchase more during periods of credit stringency. Fannie Mae, Harris argued, was too concerned with its profit-driven desire to expand its mortgage portfolio.[41]

Secretary Harris strongly criticized Fannie Mae for its suburban and upper-class favoritism. Only one quarter of Fannie's mortgages were urban, while 70 percent were suburban, she noted. Only 2 percent of Fannie's conventional mortgages were for homeowners with incomes less than ten thousand dollars (the median income in 1976 was about eleven thousand dollars).[42] Harris asserted that Fannie Mae held immense power to redistribute mortgage money and had done so to great effect on an interregional basis (e.g. From New York to L.A.). The corporation, she argued, should use this same power to redistribute mortgage money on an intra-metropolitan basis from affluent suburbs to capital-poor minority groups in the urban core.[43]

As Harris pointed out, white men dominated Fannie Mae's board. John Thompson, the president of the National Association of Mortgage Brokers, was the board's only African American. The only woman was Ruth Prokop, HUD's general counsel. Prokop and Marvin Gilman, a public policy professor at the University of Delaware, were the only members who were not financial executives.[44] President Carter had appointed Thompson, Prokop and Gilman, as well as Raymond Lapin, to the board.

Q.V. Williamson, the chairman of the National Association of Real Estate Brokers (the national organization of African American real estate professionals), joined the assault on Fannie Mae, arguing that the GSE favored suburban investment at the expense of the "inner city" and especially minority residents. Williamson had become the first black Atlanta alderman since

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[41] Ibid., 17-18.
[42] Ibid., 13.
[43] Ibid., 10.
[44] Ibid., 21.

Reconstruction in 1965. He compared Fannie Mae, as a government-sponsored corporation, to utility companies. “They can’t tell you you can’t have a telephone because you live in a certain area,” Williamson said. Fannie Mae, he said, operated as if it wasn’t “responsible to anyone… They just do what they want to do and treat citizens the way they think they ought to be treated, and not as a [sic] public citizen of this country.”[45]

Community leaders also accused Fannie and Freddie of redlining older, poorer urban neighborhoods with large minority populations. Nick Licata, a member of the Seattle Coalition on Redlining, noted how underwriting and appraisal guidelines used by the GSEs established a “dogma” that all neighborhoods inevitably declined with age. Licata also cited other criteria used by the GSEs to discriminatory effect, for example, the criterion of proximity of shopping, employment and neighborhood schools. Often, older urban neighborhoods failed to meet these standards. For example, court-ordered desegregation mandated the busing of African American students to distant majority-white schools, and, as Licata noted, this reflected poorly on GSE appraisals of majority-black neighborhoods.[46]

At the same hearings, Gale Cincotta, representatives of the Urban League, and several representatives of other community groups joined Harris in criticizing Fannie Mae’s urban disinvestment. Cincotta urged Congress to apply HMDA to the GSEs so that their patterns of investment could be brought out into the public light.[47] Conrad Weiler, chairman of the Alliance for Neighborhood Governance, testified that when Fannie Mae did invest in urban areas, its focus was on upper-class neighborhoods and gentrifying enclaves at the expense of lower-class, often minority, residents.[48]

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[45] Ibid., 77.
[46] Ibid., 59.
[47] Ibid., 43-50.
[48] Ibid., 50-52.

The AFL-CIO expressed concerns in this and other public hearings about the GSE's commitment to its public charter. They worried that Fannie and Freddie were not doing enough for the middle-class and that public oversight had been forsaken in the search for corporate profits. Yet, they did praise the GSEs' structural importance in terms of providing mortgage financing.[49]

Indeed, few critics directly questioned the basic functionality of the GSEs and the secondary mortgage market. This might have been because it seemed impossible, by the late 1970s, to halt the growth of the secondary market and reinstate the early postwar system of local lenders. Of course, the old system was far from equitable. It denied equitable access to African Americans and other minorities, as well as whites living in racially diverse neighborhoods. For groups like the Citizen's Action Program and National People's Action, the ideal would have mixed the local rootedness of the old system with the anti-discriminatory reforms passed in the late 1960s and 1970s (Fair Housing, HMDA and the CRA). But neighborhood banking was quickly disappearing and the best that people like Gale Cincotta could hope for was a more equitable, transparent and democratic secondary mortgage market. Or, as is more likely the case for some critics such as the AFL-CIO, the critics accepted the secondary market as a necessary and reasonable response to the structural economic problems of inflation and high interest rates, hoping that the middle- and lower-class might somehow share in the bounty that financialization provided.

Yet even the modest reforms proposed in the charter amendment failed to get out of the Senate committee. Fannie Mae intensely lobbied against the bill and other attempts to curtail its

[49] Ibid., 72-75.

freedom to operate as a private corporation. The GSE sent letters to every lender with whom it dealt, urging them to oppose expanding government oversight of the corporation and to contact their Congressional representatives.[50] Meanwhile, the home finance and homebuilding industries lined up behind Fannie Mae. The American Bankers Association, the National Association of Realtors, and the National Association of Homebuilders opposed any increase in presidentially appointed board members of Fannie and praised the GSE for its operations.[51]

Fannie Mae's chairman, Allen Oakley Hunter claimed that there was only so much Fannie Mae could do to overturn the systematic suburban favoritism of the housing industry. "The underwriting fraternity, the lending fraternity, the housing industry, the entire complex for many years, since shortly after World War II, has been suburban oriented," Hunter noted. Fannie Mae was "far from perfect" in its urban lending programs, he said, but, as a profit-seeking, privately owned corporation it could only do so much to promote urban lending against prevailing market norms.[52] James E. Murray, a senior vice-president at Fannie Mae, said, "we're not down in the bombed-out areas of lots of those cities, but no one else is either."[53]

Both Fannie and Freddie repeatedly claimed they could not provide data on how many of their mortgages were suburban, urban or rural. In 1977, however, HUD estimated that 70 percent of Fannie Mae's conventional mortgage purchases were suburban.[54] Fannie Mae refuted HUD's claims, arguing that it did indeed buy many loans in urban neighborhoods. But most of these loans were FHA Section 235 loans, a program racked by corruption and high foreclosure rates because they involved little risk for the financial institutions making the loans.[55] Fannie Mae

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[50] Ibid., 97.
[51] Ibid., 79-80.
[52] Ibid., 415.
[53] "Fannie Mae Fighting Senate Legislation," *Washington Post*, May 7, 1977.
[54] *Federal National Mortgage Association Charter Act: Hearings Before the Sen. Comm. on Banking, Housing and Urban Affairs,* 95th Cong. 13 (Jun. 7, 1977).
[55] Andrew Highsmith, "Prelude to the Subprime Crash," *Journal of Policy History* 24:4 (2012), 572-611.

purchased few conventional loans in these neighborhoods. "By taking FHA loans in these areas but not accepting conventional loans," Chairman Proxmire said, "FNMA is helping FHA become the vehicle for blockbusting, racial and economic turnover, and rapid deterioration in these areas." When Fannie did make conventional loans in the city, they were most often to white gentrifiers, Proxmire charged. Meanwhile, he went on, "Fannie Mae is busy generating activity which are [sic] more valuable as public relations than as programs."[56] Proxmire was referring to special Fannie Mae programs in St. Louis and Dallas that the corporation heavily publicized as evidence of its attention to urban lending needs.

The GSEs' claim that they were merely acting according to marketplace demands over which they had no control obscured their central role in creating this market in the first place. Without them, there would be no national secondary market. Their dominance over this market, sustained by their government support, provided them with immense power to shape the distribution of mortgage capital. Even bankers admitted that the private sector couldn't create a secondary mortgage market on its own. Kennon V. Rothchild, the president of the Mortgage Bankers Association, a strong proponent of "competition and the free market," told Congress in 1976 that the GSEs were essential to the development of the secondary market as a "source of new technology." The cost and risk was too much for private capital to "undertake similar ventures."[57]

Despite the many criticisms of the GSE's, major newspaper editorial boards voiced support for the "market-based," for-profit Fannie Mae. The *Wall Street Journal* editorial board argued that Harris's regulations would "wreak havoc with Fannie Mae and the mortgage

[56] *Federal National Mortgage Association Charter Act: Hearings Before the Sen. Comm. on Banking, Housing and Urban Affairs,* 95th Cong. 99 (Jun. 7, 1977).
[57] Ibid., 159.

market." Critics of Fannie Mae who argued that the association was redlining urban neighborhoods were ignorant of "basic economics," the editorial stated. According to the *Journal,* there was little demand for low-income urban mortgages.[58] The *New York Times* editorial board wrote that Harris's goal of housing "poor families in the older cities" was a "laudable objective" but was not a reasonable one for a privately owned corporation like Fannie. It was a simple matter of business prerogatives. In order to be most efficient, Fannie Mae had to maintain its profitability. The editorial took for granted that "inner-city" mortgages were "high risk." "Inner-city residents who need housing help most acutely cannot afford the reasonable costs of occupying buildings. Making loans to them… is a futile exercise unless the Government also offers subsidies." There were special programs under HUD, the FHA and Ginnie Mae that offered subsidies. Fannie Mae, the editorial argued, was not in the business of subsidies. The editorial likened Harris's campaign against Fannie Mae's lending policies as an unwanted "courtship" and warned that Fannie Mae could "lose her reputation" if Harris succeeded.[59] Wall Street suitors might be less than eager to enter into a relationship with a Fannie Mae that had lost her free-market virginity to government regulation.

Barron's took the sexual metaphor further, calling Harris's efforts the "rape of Fannie Mae." The editorial credited the corporation's success to its private, profit-driven status and cited HUD's "dismal history of failure" as a warning against government involvement. According to the editorial, HUD policies had created "statist slums," most infamously the Pruitt-Igoe Housing Project in St. Louis. A HUD-controlled Fannie Mae would repeat the process on a larger scale.

[58] "The Fannie Mae Raid," *Wall Street Journal*, Apr. 24, 1978.
[59] "The Courtship of Fannie Mae," *New York Times*, Feb. 10, 1978.

“What [HUD officials] really seek,” the editorial claimed, “is federal allocation of credit and consequent control over U.S. economic life.”[60]

The committee voted against sending the bill to the full Senate but it did send a memo to Fannie Mae outlining its areas of concern and warning the corporation that if it did not improve in these areas, the committee would reconsider the bill. The memo found three “general categories of concern”:

> First, that FNMA appears to be too restrictive in setting its standards for the acceptability of conventional urban loans, thus reinforcing the disinvestment patterns of other lenders;
> Second, that FNMA appears not to be restrictive enough in buying FHA loans, and has, through the indiscriminate purchase of these mortgages, contributed to rapid turnover and instability in inner-city areas; and
> Third, that FNMA, to the extent it does purchase conventional urban loans, appears to concentrate on mortgages for affluent people buying higher priced homes.[61]

The result, as testified to “repeatedly from neighborhood residents, public officials and academic witnesses,” was a “pattern” of “neighborhood deterioration… known as the FHA-ing of urban areas.” Financial institutions replaced conventional lending with government-insured FHA loans. The latter were risk-free and opened the door to rampant speculation, facilitated by “racially-based panic-selling and ‘block-busting.’” Speculators sold homes at exorbitant prices to homebuyers, often low-income African Americans. The mortgages often ended up in foreclosure. While lenders recouped their losses through FHA insurance, “the family loses the home, the taxpayer is left with huge aggregate losses to repay, and the neighborhood is blighted by the presence of HUD-owned, vacant and often unsalable properties.” Even if homebuyers were able to avoid foreclosure, “the neighborhood has been manipulated into a wholesale racial

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[60] “Rape of Fannie Mae?” *Barron’s,* Feb. 27, 1978.
[61] *Memorandum Regarding the Policies and Performances of the Federal National Mortgage Association, Committee on Banking, Housing and Urban Affairs, U.S. Senate,* 95th Cong. 2 (Nov. 1977).

and economic turnover, rather than having had the opportunity to undergo stable and gradual integration." In other words, the process further strengthened the link between racial integration and economic decline that was so powerful in terms of market logic and cultural discourse.[62]

The memo also concluded that Fannie Mae's lending standards, along with those of the major private appraisal industry groups and Freddie Mac, disadvantaged urban and black neighborhoods. After the 1968 Fair Housing Act, these institutions removed explicit references to race. However, "related antiurban concepts… were generally retained," the memo stated, "and other concepts were often added to act as surrogates for the prohibited criteria."[63] Fannie's lending standards were "widely used in the housing market as a whole, even by lenders who may not plan to sell their mortgages." The memo went on to criticize the assumption that social homogeneity was universally desirable. In many neighborhoods, there was a "growing preference for social heterogeneity. In such areas, the traditional social groupings have little or no relevance in the appraisal process. In a changing society. there can be no universal set of social standards, and the factors that are relevant in one neighborhood may be irrelevant in another." The goal should be a locally sensitive program with "relevant" factors that could be "objectively measured."[64]

Fannie Urban Programs

Having failed to increase Administration control over Fannie Mae's board, Harris attempted to act on her own by issuing regulations that would have required the association to purchase 30 percent of its mortgages from urban areas and 30 percent for low- and moderate-income homebuyers. It was a modest sum, given that 70 percent of the association's mortgages would

[62] Ibid., 2-3.
[63] Ibid., 9.
[64] Ibid., 12.

have remained upper-class and suburban. Yet, Fannie vigorously resisted Harris's efforts, threatening to sue over the proposed regulations. Finally, in August 1978, a compromise was reached: Fannie Mae would accept the thirty percent thresholds as "goals" rather than "requirements." It was a compromise heavily tilted towards Fannie Mae. Failure to meet the goals would trigger a cumbersome process: HUD could require Fannie to submit a plan to meet the goals. If HUD thereafter rejected that plan, the agency could require Fannie to hold a special auction for low-income, urban mortgages.

To meet the 30 percent urban lending goal, Fannie Mae created a set of new programs designed to stimulate urban lending. According to a HUD audit, the association fulfilled its required urban lending in 1978, with thirty-one percent of its purchases, totaling $6.1 billion, urban. HUD also determined that thirty-six percent of Fannie's purchases were for low- or moderate-income homebuyers. Yet, by 1980, with the housing industry in recession, HUD found Fannie's urban lending programs were falling far short of their goals. Its special urban lending programs represented a sliver of Fannie's gigantic portfolio, more than $148 billion in 1980, of mostly suburban mortgages. One HUD official said the urban lending programs amounted to "blue smoke and mirrors."[65]

Furthermore, Fannie's urban lending was heavily concentrated in Western and Southern cities. More than half of its urban loans were made in just three states—California, Texas and Washington. The association's urban programs focused on Sun Belt cities where annexation had created sprawling central cities. These cities included neighborhoods that had previously been suburbs and were only nominally urban. Fannie Mae's urban lending purchases in Houston

[65] "FNMA Urban Program Falls Short of Its Goals," *Washington Post*, Apr. 19, 1980.

amounted to more than all of its purchases in the eight largest cities in the Northeast. Outside of the Sun Belt, Fannie's purchases were overwhelmingly suburban. Only 13 percent of its Washington, DC metro area purchases were in the central city. In Newark, only nine percent were in the central city.[66]

The New Political Calculus of Mortgage Policy in the Early 80s

Vital to the growth of the secondary market in the 1980s was the development of new securitization techniques, most importantly the collateralized mortgage obligation (CMO). CMOs were first issued by a consortium of Freddie Mac, First Boston Bank and Salomon Brothers in 1983. They brought fame to a banker, Lewis Ranieri, who worked at Salomon Brothers and was instrumental in developing the techniques behind CMOs. The CMO made mortgage-backed securities (MBS) much more attractive to institutional investors on Wall Street. By dividing pools of mortgages into several tranches—each with its own level of risk and schedule of payment—CMOs were able to provide investors with a much greater level of certainty than early forms of MBS. Investors could chose to buy higher-risk, higher yielding securities or lower-risk, lower yielding securities. By 1986, the value of MBS issued was twice that of all the corporate bonds issued.[67] Ranieri received much of the credit for the growth or mortgage securitization. Indeed, he claimed to have coined the term "securitization." Yet the fundamentals of mortgage securitization had been developed fifteen years earlier when the Johnson Administration passed the 1968 Housing Act. Although Ranieri and his Wall Street colleagues merely helped to grow the market, their story, as told in Michael Lewis's *Liar's*

[66] "FNMA Urban Program Falls Short of Its Goals," *Washington Post*, Apr. 19, 1980.
[67] Roth, "Volatile Mortgage Markets," 21.

Poker, was highly entertaining. Greedy, cigar-smoking Wall Street traders made for better anti-heroes than Washington bureaucrats.[68]

A transformation in the politics of mortgage policy as well as economic turbulence at the end of the 1970s and the early 1980s aided the growth of the mortgage securities market, particularly CMOs. For Congressional liberals and the Carter Administration, concern for middle-class homeowners and savers superseded issues of financial equity raised only a few years earlier. The housing crisis and high interest rates of the early 1980s meant that middle-class suburbanites experienced similar conditions that had plagued the urban poor and working classes for years: higher mortgage costs—if mortgages were available at all—and destructive cycles of delinquency and foreclosure. With middle-class homeownership under threat, liberals turned their attention away from the urban poor and working classes and focused their efforts on providing enough money for the mortgage markets so that the New Deal promise of homeownership could survive the new economic landscape. With thrifts under crisis, Congressional liberals increasingly embraced the GSEs as the prime inheritors of the New Deal mandate for national homeownership.

For conservatives, the election of Ronald Reagan heralded a new era of political possibility, one where the dismantling of key New Deal policies, including government support for mortgages, was on the agenda. The Reagan administration fought to sever the GSEs' government ties and increase opportunities for private institutions in the secondary mortgage market. According to them, liberalism's interference in the marketplace had caused inflation and all its related problems for middle-class homeowners and savers. They argued that mortgage

[68] Michael Lewis, *Liar's Poker: Rising Through the Wreckage of Wall Street* (New York: Penguin, 1990).

markets would be most efficient without the government-sponsored "duopoly" of Fannie and Freddie.[69]

However, both liberals and conservatives in Washington agreed that the secondary market, whether public or private, needed to be stimulated in order to satisfy mortgage demand. Even before the housing crisis of the early 1980s, policymakers were concerned about the ability of the financial system to fund the construction of new homes. Beginning with the Johnson administration, they forecast growing demand for new housing in the 1970s, 1980s and beyond as baby boomers came of home-buying age. Millions of new homes would be needed. The secondary market, they said, could help satisfy the demand by attracting new funds to mortgages. By augmenting traditional methods of home finance, the secondary market would help to carry forward the American Dream of homeownership for a new generation.

In the early 1980s, when thrifts began to fail at record rates and traditional sources of mortgage finance dried up, policymakers issued dire warnings about the ability of the home finance system to meet the demands of baby boomer families.[70] According to Philip Brinkerhoff, president of Freddie Mac, the nation was facing the "greatest crisis" in home finance "perhaps since the depression." Freddie Mac forecasted that almost 17 million new households would be formed during the 1980s.[71]

The coincidence of rising demand for and shrinking supply of home finance dollars provided advocates of the secondary market a powerful, new argument: the secondary market would have to grow significantly and quickly in order to take the place of thrifts as the prime

[69] *Legislative Proposals Concerning FNMA and FHLMC: Hearings Before the Subcommittee on Housing and Community Development of the Committee on Banking, Finance, and Urban Affairs, House of Representatives,* 98th Cong 50 (May 17, 1983) (statement of Lawrence A. Kudlow, Assoc. Director for Economics and Planning, Office of Management and Budget).
[70] On thrift failures see, for example, Mason, *From Building and Loans to Bail-Outs*.
[71] *To Expand and Reorganize the Federal Home Loan Mortgage Corporation: Hearings Before the Subcommittee on Housing and Community Development of the Committee of Banking, Finance, and Urban Affairs, House of Representatives,* 97th Cong. 285 (Apr. 21, 1982).

source of mortgage financing. Freddie Mac claimed that the secondary market would need to provide $2.85 trillion in financing. At their then current rates of growth, Freddie, Fannie and Ginnie would only be able to provide about a third of this sum. They would need to grow much faster, Brinkerhoff argued: "a business-as-usual attitude toward the future of the secondary market could seriously impair opportunities for homeownership by American families." Brinkerhoff continued, "With the scheduled elimination of Regulation Q and the evolving realities of inflation, lending institutions, whether they are thrift institutions or commercial banks, will never again finance on a broad basis long-term fixed rate mortgage loans with short-term deposit funds." Volatile interest rates, he said, would force financial institutions to lend on shorter terms. In terms of mortgage lending, lenders would only be able to directly finance short-term and/or adjustable-rate mortgages with higher rates, a reality, Brinkerhoff noted, that would especially disadvantage middle and lower-class homebuyers. The only way for fixed-rate mortgages to survive, he claimed, was through the growth of the secondary market.[72]

The GSEs proposed that Congress grant them new powers to enlarge the secondary market. In 1982, Freddie proposed its own reorganization, transferring ownership from the FHLB system and recapitalizing it with private funds—and making its ownership status similar to Fannie Mae. With the thrift industry in crisis, private ownership would provide Freddie with new sources of capital. In 1983, the GSEs lobbied Congress for new purchasing authorities and replacement of HUD oversight with direct Congressional oversight. The purchasing proposals included an increase in the maximum limit for mortgage purchase prices in high-cost areas, like

[72] *To Expand and Reorganize the Federal Home Loan Mortgage Corporation: Hearings Before the Subcommittee on Housing and Community Development of the Committee of Banking, Finance, and Urban Affairs, House of Representatives,* 97th Cong. 58 (Apr. 21, 1982).

California. This would allow Fannie and Freddie to buy more expensive mortgages. The proposal also included authority to purchase non-residential mortgages.[73]

Although White House opposition ultimately defeated the GSEs' efforts, the Congressional hearings on the proposed expansion of purchasing authority illustrated the new political landscape of home finance. Rep. Henry B. Gonzalez, chairman of the Committee on Banking, Finance and Urban Affairs expressed the urgency felt by Congressional liberals. "The greatest dilemma of the housing industry is where tomorrow's source of mortgage money will come from," he said in 1982. "No one needs to be reminded of the level of demand expected to be coming in the next 10 or 20 years," he continued, "No one needs to be reminded that both the primary and secondary market are absolutely essential to make that housing production possible."[74] In 1983, Rep. Gonzalez reiterated the importance of finding new sources of mortgage capital: "Housing is, in a word, finance." Gonzalez wondered where the financing of the future would come from. "If there is no way to provide affordable financing, there's no way to provide affordable housing," he warned. It was not clear how home finance could survive in a new era of high and volatile interest rates. "We have lost all of the framework of reference of our financial institutional underpinning for the production and the delivery of mass housing at affordable prices," he said.[75]

S&Ls, which had formed the institutional bedrock of the home finance system, were in crisis. In attempts to save them, Congress had granted them authority to diversify their

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[73] *Legislative Proposals Concerning FNMA and FHLMC: Hearings Before the Subcommittee on Housing and Community Development of the Committee on Banking, Finance, and Urban Affairs, House of Representatives,* 98th Cong (May 17-18, 1983).

[74] *To Expand and Reorganize the Federal Home Loan Mortgage Corporation: Hearings Before the Subcommittee on Housing and Community Development of the Committee of Banking, Finance, and Urban Affairs,* 97th Cong. 1 (Apr. 21, 1982).

[75] *Legislative Proposals Concerning FNMA and FHLMC: Hearings Before the Subcommittee on Housing and Community Development of the Committee on Banking, Finance, and Urban Affairs, House of Representatives,* 98th Cong 1-3 (May 17, 1983).

investments, thus diminishing their historical reliance on mortgages. In 1980, the Depository Institutions Deregulation and Monetary Control ACT (DIDMCA) allowed thrifts to make consumer loans and commercial real estate loans, issue credit cards, and offer negotiable order of withdrawal (NOW) accounts. And in 1982, the Garn-St. Germain Depository Institutions Act further expanded thrifts' ability to make a variety of different types of loans.[76] "Even if they don't want to," Gonzalez said in 1983, "they have been propelled and edged away from the mortgage market…. Today, for all practical purposes, we do not have any institutions that are in the sole business of originating mortgages." With S&Ls becoming less important for home finance, the secondary market and particularly its "inventors" and "leaders," Fannie and Freddie, were increasingly vital.[77]

Gonzalez urged his colleagues to accept the new financial landscape and approach the problem of home finance "based on practical realities" rather than "sterile ideology." He was primarily aiming this criticism towards the "free-market" ideologues in the Reagan administration and Congress, who sought a diminished role for the GSEs relative to private institutions in the secondary mortgage market. But his call for pragmatism was also an indication that liberal policymakers were increasingly inclined to support Fannie, Freddie and the secondary market in general in order to preserve mortgaged homeownership as a central policy goal. Preserving this goal relegated criticism of the GSEs lending policy, its suburban, racial, and regional biases, to the sidelines. In Gonzalez's eyes, hope for reviving the postwar system of local S&Ls was unhelpful nostalgia for a system that no longer fit economic reality.

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[76] For a summary of DIDMCA and Garn-St. Germain see Mason, *From Building and Loans to Bail-Outs*.
[77] *Legislative Proposals Concerning FNMA and FHLMC: Hearings Before the Subcommittee on Housing and Community Development of the Committee on Banking, Finance, and Urban Affairs, House of Representatives,* 98th Cong 1-3 (May 17, 1983).

Meanwhile, administration officials argued that that the GSEs enjoyed “unfair” advantages due to their government sponsorship and that private, “unsubsidized” institutions could more “efficiently” operate in the secondary market. Lawrence Kudlow, an associate director at the Office of Management and Budget, argued that government support for the GSEs had created a “government duopoly.”[78] Instead of granting GSEs increased power, they should be fully separated from the government.

Fannie Mae defended itself against White House criticism by both downplaying its dominance and embracing the New Deal mandate of providing homeownership opportunities to the middle class. Fannie Mae’s chairman, David Maxwell, argued that Fannie Mae’s share of the market was “moderate” and there was ample room for private institutions to enter the market. On the other hand, Maxwell argued that the GSEs’ special privileges were a “tradeoff” for pursuing national homeownership goals. Administration attempts to “privatize” the secondary market amounted to “oppos[ition] to the historic American policy that accords a high national priority to the funding of housing.”[79] It was a rhetorical about-face. Since 1968, Fannie Mae had heavily advertised its “free market” credentials (as in the 1976 and 1977 hearings) in seeking to differentiate itself from other government housing programs and maintain its prerogatives as a privately owned, for-profit corporation. But now, eager to consolidate Congressional opposition to Reagan’s privatization plans, Fannie embraced its special relationship with the government and its status as the inheritor of New Deal liberalism’s support for home finance.

The Reagan administration failed in its attempts to curtail the GSEs. Congressional liberals rallied around Fannie and Freddie. They put aside their earlier critiques of GSE policies as they sought to preserve middle-class access to the low-cost, low-risk mortgages that had been

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[78] Ibid., 64.
[79] Ibid., 76.

created by the New Deal. Despite the limited ability of Congress or the White House to shape GSE policies, a fact highlighted by the mostly unsuccessful efforts of Harris and Proxmire only a few years earlier, liberals now saw the GSEs as the government's most powerful method for shaping mortgage markets. Meanwhile, the GSEs immense political and economic power (they now rivaled the nation's largest corporations in terms of assets) ensured bipartisan Congressional opposition to the Administration's most radical policy proposals.

Conclusion

The end result was a compromise, the Secondary Mortgage Market Enhancement Act (SMMEA), which Reagan signed into law in 1984. Reflecting a consensus that, whether public or private, the secondary market was now the most important source of mortgage money, SMMEA bolstered both GSE and private opportunities in the secondary market. The Act allowed financial institutions, whether federal- or state-chartered, to invest in both private and GSE mortgage securities. Where state law prohibited mortgage-backed securities (MBS) investment, SMMEA made MBS equivalent to U.S. Treasury obligations, allowing state-chartered institutions to buy MBS to the same extent as Treasury bonds. Policymakers hoped this would help stimulate demand for both private and GSE securities. SMMEA also authorized the GSEs to purchase manufactured homes and second mortgages, providing a whole new market for GSE securitization.

The institutions that stood to gain from an expanded secondary mortgage market—mortgage bankers, securities firms and the GSEs—supported the passage of SMMEA. Lewis Ranieri testified in support of SMMEA, arguing that only with increased opportunities for private traders in MBS would the nation be able to meet its housing goals.[80] John Teutsch, representing the Mortgage Bankers Association of America, testified that the growth of the secondary market was the only way to preserve mortgage affordability.[81] And Mark Goldhaber, Freddie Mac VP for public affairs, praised SMMEA for "level[ing] off the playing field [and] providing equal access and opportunity for all the players." With several new powers in hand and having blocked any reduction in government support for the GSEs, Goldhaber was content that the new opportunities for private institutions in the secondary market would not hamper Freddie's continued expansion. "The market is big enough for everyone," he said.[82]

While GSEs and Wall Street firms supported SMMEA, the thrift and banking industries opposed the act, fearing that it would further erode their traditional role in the home finance market. Michael Wise, an S&L executive in Denver and member of the Mortgage Securities Task Force of the United States League of Savings Institutions, warned that SMMEA could "undermine our proven mortgage delivery system." Wise warned that SMMEA would "concentrate the capital for home finance" in the hands of Wall Street. The "nontraditional investors and nontraditional mechanisms… reshaping housing finance… could prove to be fair weather friends unlike our specialized institutions which have a large and continuing commitment to serving the home buying public," Wise testified.[83] Keith J. Willoughby, president of Mutual Bank of Boston and a member of the National Council of Savings Institutions, echoed Wise's testimony: "We think that the lack of participation of local financial institutions in the

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[80] *Secondary Mortgage Market Enhancement Act: Hearings Before the Subcommittee on Telecommunications, Consumer Protection, and Finance of the Committee on Energy and Commerce, House of Representatives*, 98th Cong. 245 (Mar. 14, 1984).
[81] Ibid., 115.
[82] "Law may help to improve flow of mortgage funds," *Chicago Tribune*, Oct 27, 1984.
[83] *Secondary Mortgage Market Enhancement Act: Hearings Before the Subcommittee on Telecommunications, Consumer Protection, and Finance of the Committee on Energy and Commerce, House of Representatives*, 98th Cong. 144 (Mar. 14, 1984).

marketing of such securities will lead to the concentration of capital flows."[84] The American Bankers Association also critiqued SMMEA for "unfairly benefit[ing]… four or five dominant securities firms."[85] Opposition from these thrifts and banks proved unsuccessful. SMMEA passed both houses of Congress by voice vote and was signed into law by President Reagan on October 3, 1984.

The enactment of SMMEA coincided with another, even more disastrous, thrift crisis. The crisis at the beginning of the decade had briefly and only partially subsided as inflation dropped and Congress deregulated thrift asset powers (granting thrifts the ability to invest in a wider array of instruments beyond their traditional reliance on mortgages). In the short-term, these new powers provided thrifts with an infusion of capital but, in the long term, these new investments also carried higher risks. Thrifts overextended themselves by investing in a wide variety of volatile investments, including commercial loans and junk bonds. S&Ls, once the domain of conservative businessmen eager to reap the stable rewards of the New Deal home finance system, now became a vehicle for cavalier and often corrupt financiers searching for quick profits.[86] During the second half of the decade thrifts failed at record rates, decimating the industry. Those that survived became increasingly indistinguishable from banks. Meanwhile, SMMEA fueled the explosive growth of mortgage securitization and the GSEs. The thrift crisis coupled with the increasing dominance of mortgage securitization heralded the denouement of the New Deal home finance system and a redefinition of mortgaged homeownership.

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[84] Ibid., 188.
[85] Ibid., 202.
[86] See, for example, Mason, *From Building and Loans to Bail-Outs.*

Chapter 6

From Boomtown to "Foreclosure City": Home Finance in Houston

"The causes of growth," Houston developer David Wolf told Congress in 1978, "are often in turn caused by the growth itself."[1] Houston was in the midst of a homebuilding boom. Thousands of new homes had sprung up in far-flung suburbs—master-planned communities of homes uniform in style and price. Wolf credited the city's "pro-business" atmosphere for allowing the homebuilding industry to capitalize on the area's demand for new homes without the aid of government support. Houston's boom, another developer agreed, was the product of the city's embrace of "free market forces and the entrepreneurial spirit."[2] These developers, however, omitted a key cause of Houston's homebuilding boom: Fannie Mae and Freddie Mac, the government-sponsored enterprises (GSEs) that had created and sustained an expanding secondary market in mortgages from the 1970s onward. GSE policies reinforced regionally divergent growth trends throughout the country by channeling millions of dollars worth of mortgage capital to rapidly expanding metropolitan areas like Houston. Growth created more growth, thanks to Fannie Mae and Freddie Mac.

Eight years later, boom had turned to bust. Kenneth Graeber was one of thousands of Houston homeowners who received notice that they were behind on their mortgage payments.

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[1] *Task Force on Homeownership: Hearings Before the Subcommittee on Housing and Community Development of the Committee on Banking, Finance and Urban Affairs*, *House of Representatives*, 95th Cong. 650 (Jan. 24, 1978) (Statement of David S. Wolf).

[2] Ibid., 606 (Statement of Tyler Todd).

Graeber was "bewildered."[3] He had always paid on time. Furthermore, the notice came from Gibraltar Savings, which was puzzling because Graeber had gotten his mortgage from Couch Mortgage Company. Soon after, he received another letter. This time it was from Columbia Savings, claiming that they were due mortgage payments from him. A third letter, from Couch, followed. Each institution claimed that Graeber owed it mortgage payments. If Graeber didn't pay, he was at risk of facing foreclosure three times over. As it turned out, Couch had fraudulently sold his mortgage to both Gibraltar and Columbia. Graeber was one of hundreds of homeowners that now confronted multiple financial institutions with claims on their mortgages. To make matters worse, Couch filed for bankruptcy in October. Homeowners were soon caught up in a legal battle with Couch's creditors that lasted for years and left the threat of foreclosure lingering.

Graeber was Harris County's chief real estate appraiser but his expertise in real estate had been no inoculation against Couch's fraud. He, like thousands of other Houston homeowners, were unaware that the financial institutions from which they obtained mortgages immediately sold them to other institutions, or as in Couch's case more than one institution. Most often, these sales were pre-determined before the homeowner bought the house. Financial institutions that bought mortgages provided originating institutions with a forward commitment to buy mortgages on homes that were not yet sold. Almost always, these commitments were made in bulk to subdivision developers. Meanwhile, homeowners continued sending their payments to the institutions that originated and serviced their mortgages.

[3] Scott Clark, "Multiple mortgages, conflicting claims," *Houston Chronicle*, Mar. 19, 1987.

Couch mostly sold its mortgages to other S&Ls, but many financial institutions that originated mortgages sold them to Fannie Mae and Freddie Mac. The GSEs, in turn, sold bonds and securities based on these mortgages to investors across the country. The growth of the GSEs and the development of collateralized mortgage obligations (CMOs) spurred the growth of the secondary market during the 1970s and 1980s. By the end of the 1980s, most new mortgages were sold on the secondary market, with the bulk going through the GSEs.

The growth of the secondary market, and the forward commitment system that went with it, provided residential developers with free-flowing capital to finance new home construction in large-scale developments. The effects of this transformation were especially profound in southern and western cities, such as Los Angeles, Houston, and Atlanta. In Houston, where the growth of the secondary market coincided with a regional oil boom, developers built hundreds of new subdivisions with the use of secondary-market financing. The Houston metropolitan area grew by almost one million people during the 1970s, reaching 3.15 million in 1980, the ninth-largest city in the nation.

It was no accident that Houston and Los Angeles were among the prime beneficiaries of the secondary market's growth; this trend was a product of policy. Since the 1968 Housing Act, one of the primary goals of Fannie Mae and Freddie Mac was to redirect mortgage money from capital-rich regions, mostly in the Northeast and Midwest, to capital-poor regions, mostly in the South and West. Fannie Mae and Freddie Mac provided a direct and secure method for northeastern and midwestern institutions to invest in southern and western mortgages. Indeed, their growth funneled hundreds of millions of dollars from the North to the South and from the East to the West. They were working better Raymond Lapin had imagined they would. Lapin, his banker friends and Washington policymakers had been unable to imagine the financial, infrastructural and social dislocations unrestricted capital would unleash on the new suburbs of the Sun Belt.

Despite the lofty goals of the Housing Act, securitized mortgages accelerated the growing inequality of access to mortgage finance along racial lines in this "New South City." The new system favored large-scale suburban development to the exclusion of urban neighborhoods. African Americans and Latinos joined whites in moving to the suburbs during the period, but systematic discrimination denied them equal access to affordable mortgages and produced broad patterns of suburban segregation. Western suburbs were overwhelmingly white, while eastern suburbs were more diverse. The former were home to the fastest growing areas of Houston. Fannie, Freddie and Wall Street investors eagerly bought mortgages in western suburbs. But developers found it much more difficult to procure financing for eastern development on the same terms as in the west.[4] Thus, mortgages in these areas were more expensive and riskier. The mortgage bonanza created by the oil boom and securitization financed sprawl in all directions but on an unequal basis.

At the same time that Houston's 1970s boom illustrated how the securitized home finance system could quickly generate a new landscape of large-scale subdivisions, the city's bust after oil prices collapsed in the early 1980s revealed the immense risk in the new system. Homes across the region entered foreclosure. Developers, S&Ls and banks failed at record numbers. The S&L industry was especially troubled. Record-level interest rates during the 1980s endangered their viability. Financial deregulation, in the form of the Depository Institutions Monetary Control Act (DIMCA) of 1980 and the Garn-St. Germain Act of 1982 allowed thrifts

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[4] *Homeownership Task Force: Hearings Before the Subcommittee on Housing and Community Development of the Committee on Banking, Finance and Urban Affairs, House of Representatives, Part 1*, 95th Cong. 631 (Jan. 24, 1978) (Statement of Tyler Todd).

to engage in a wide variety of speculative investments. Intended as a lifeline to the thrift industry, these deregulatory measures only deepened the thrift crisis by encouraging reckless and short-sighted business practices.[5] Less than three months after Kenneth Graeber received multiple claims for his mortgage—three months into the years-long saga of facing foreclosure—he announced, in his capacity as chief appraiser, that Harris County's tax base was declining and that it would probably continue to decline along with property values. A resulting reduction in government services and/or tax hikes exacerbated the crisis facing homeowners.

Houston's bust was shocking to its residents, many of whom were first-generation arrivals. It was the opposite of what they had been promised. Developers had advertised their suburbs as offering a greater sense of community than the city. They promoted the idea that the ideal neighborhood could be produced and sold as a consumer product. Master planning supposedly created orderliness and homogeneity, in contrast to the diversity and messiness of city life. The new subdivisions also offered local governance on a small scale. But this governance was not public. Instead, private homeowner associations provided basic community services and maintained the aesthetic uniformity of the subdivision. Often, these homeowner associations weren't actually *homeowner* associations; they were *developer* associations. Covenants created by the developer decreed that associations would remain under developer control until it sold a supermajority of lots. Many subdivisions built during the boom never achieved the threshold. Meanwhile, for homeowners, membership fees were mandatory. Voting rights were determined by ownership status. Individuals had no voting rights independent from homeownership.

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[5] See, for example, Kathleen Day, *S&L Hell: The People and Politics Behind the $1 Trillion Savings and Loan Scandal* (New York: W.W. Norton & Co., 1993).

The foreclosure crisis put homeowner-association systems of local governance in jeopardy by the mid-1980s. The crisis was especially severe in less affluent and racially diverse subdivisions, but it extended to white middle-class subdivisions as well. After a critical mass of foreclosures, homeowner associations went defunct and left their subdivisions without basic municipal services. Parks weren't maintained, streetlights went out and garbage piled up. Homeowners became increasingly frustrated.

Yet, the Securitized System obscured the people and structures responsible for Houston's bust. Securitization and the consolidation of the financial industry hid power behind multiple layers of complex and opaque financial arrangements. Many homeowners did not know who owned their mortgage. The institutions closest to homeowners—local developers, thrifts and banks—went bankrupt, divested themselves from residential housing, or were absorbed by larger institutions. In 1987, the Federal Home Loan Bank Board (FHLBB) unveiled a program to merge scores of troubled thrifts. Called the Southwest Plan because of its focus on Texas and neighboring states, the program provided billions of dollars in federal subsidies to investor groups willing to assume control of the new mega-thrifts created by the mergers. These investor groups were led by prominent financial executives, many from New York, including Lewis Ranieri, the Salomon Brothers investment banker who had helped pioneer the development of CMOs.[6] Houston homeowners were confronted with a home finance system where power was more distant, hidden, and concentrated.

Despite their insulation from direct political protest, the powerbrokers of the Securitized System in Houston were still concerned about the negative effects of homeowner discontent.

[6] Peter Elkind, "Rock Bottom," *Texas Monthly* 17:6 (Jun. 1989), 129; Martin E. Lowy, *High Rollers: Inside the Savings and Loan Debacle* (New York, Praeger, 1991), 204.

They worried that blighted suburbs and angry homeowners could spark concerted political action and damage the city's image. Thus, Houston's home finance, development and real estate elites, along with HUD, the VA and Fannie Mae, sponsored a program called "Adopt-a-Subdivision," which was part of a larger business campaign called "Houston Proud." The program sought to clean up the wreckage left behind by homeowner foreclosures and the failure of numerous financial institutions and developers. Its main objective was to revitalize Houston's homeowner associations and resurrect the vision of the ideal community that developers had promoted during the city's boom years. "Adopt-a-Subdivision" was an attempt by the new elite of the Securitized System to assert control over the subdivisions that had orphaned by the wave of failures in the thrift and development industries.

The onus of revitalizing communities fell to homeowners. In commodifying "community" with the use of abstract symbols, developers denied the social embeddedness of their subdivisions and obscured the institutional causes behind their growth. When boom turned to bust, this understanding of the "community" as a commodity without a social history worked in tandem with the invisibility of power within the Securitized System. Without identifiable villains in the home finance or homebuilding industries, many blamed homeowners, rather than institutions, for neighborhood decline. Homeowners had supposedly been poor caretakers of the commodity that had been sold to them. According to Houston Proud, defunct homeowner associations and subdivisions in decline resulted from a lack of "community spirit" and a dearth of "positive attitudes" among homeowners. The solution, they said, could be found in rehabilitating homeowners themselves with a little charitable help from Houston's business community.

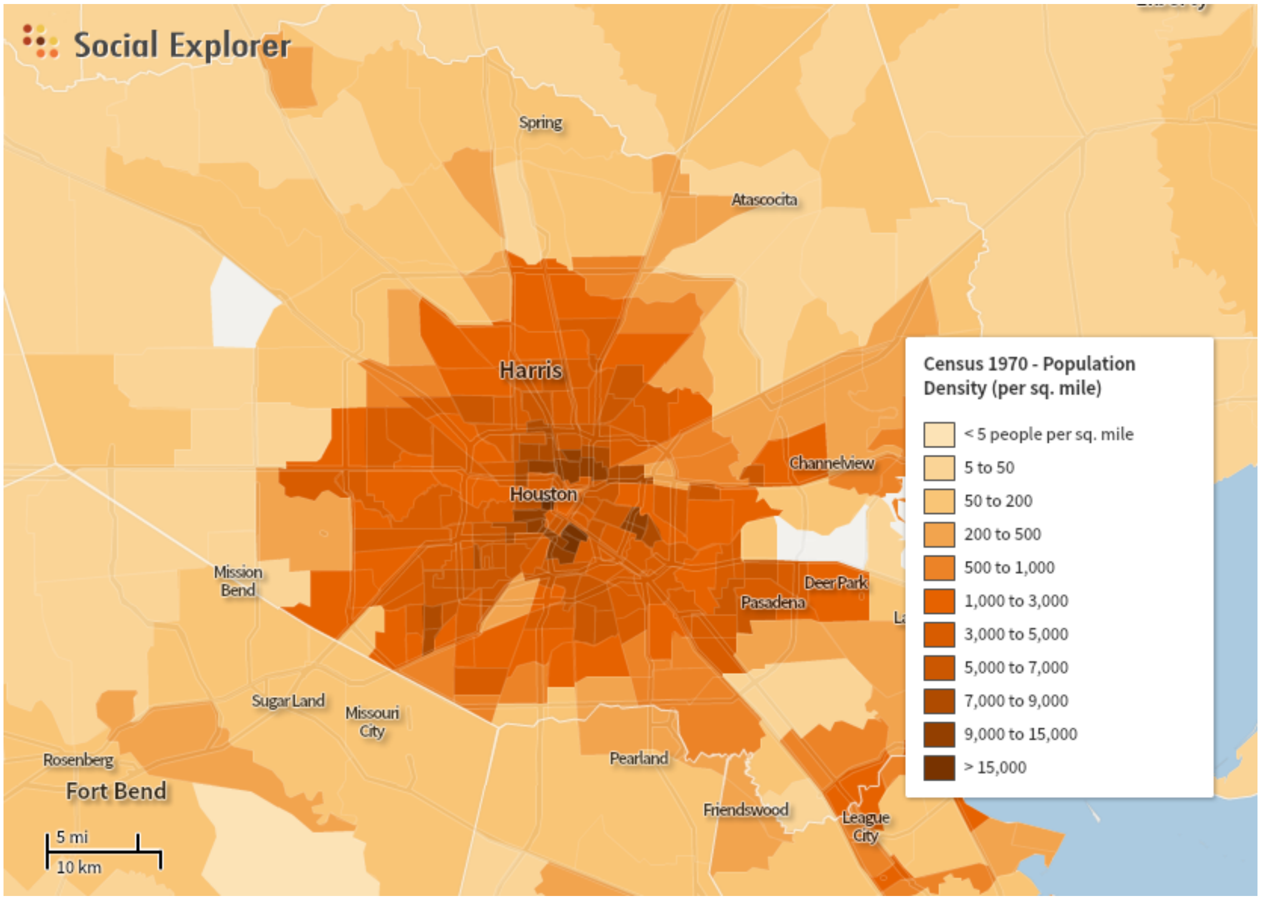

Figure 6.1 Houston Population Density, 1970.
Source: Population Density, 1970, Social Explorer (based on data from U.S. Census Bureau; accessed Dec. 2, 2013).

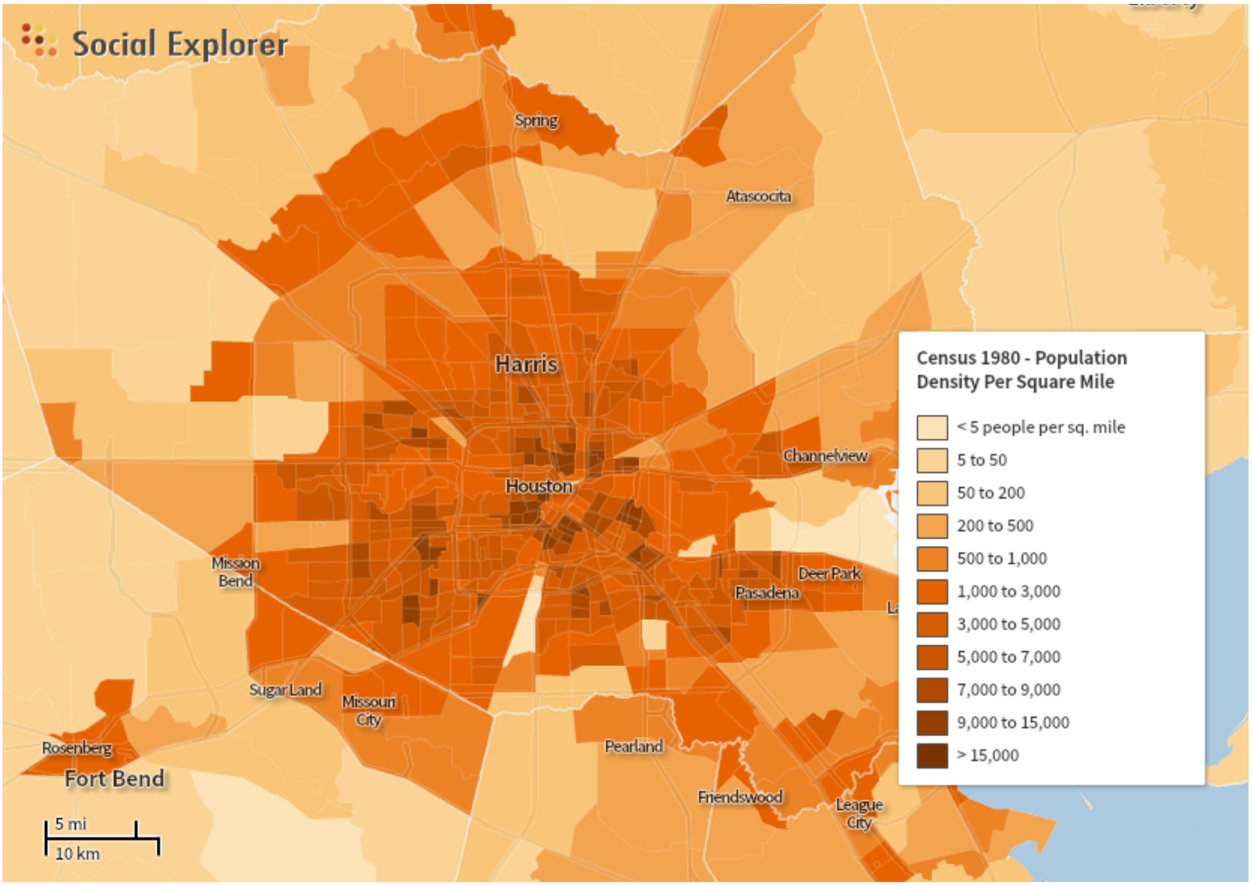

Figure 6.2 Houston Population Density, 1980.
Source: Population Density, 1980, Social Explorer (based on data from U.S. Census Bureau; accessed Dec. 2, 2013).

The Secondary Market

In cities like New York and Chicago, financial institutions had built up significant capital reserves over many decades of commercial growth. Financial institutions in cities such as Houston and Los Angeles also had a lot of money, but relative to their region's demand for home finance, their capital reserves were much smaller than their eastern and northern colleagues. As a result, mortgage interest rates were often significantly lower in New York and Chicago as compared to Houston and Los Angeles.[7] Before 1968, some western and southern financial institutions were able to secure northeastern and midwestern investors. But the difficulty and risk

[7] Howard L. Roth, "Volatile Mortgage Rates—A New Fact of Life," *Federal Reserve Bank of Kansas City Economic Review* (Mar. 1988), 20.

of financing mortgages on the other side of the country constrained these institutions' ability to attract enough funds to satisfy demand. For example, in 1981, thrift institutions in the Chicago metropolitan area held $72 billion in deposits. In, Houston total deposits were only $18 billion.[8] Houston needed other sources of home finance dollars in order to satisfy demand. As the designers of the 1968 Housing Act intended, the growth of the secondary market significantly reduced obstacles to the interregional transfer of mortgage funds and provided new sources of home finance, especially for developers in southern and western cities.

The interregional transfer of mortgage funds facilitated by Fannie and Freddie significantly diminished the interest rate differential between high-growth regions and slow-growth regions. Historically, rates had been as much as two percentage points higher in cities like Los Angeles and Houston as compared to cities like New York and Chicago. By 1984, the *New York Times* reported that, thanks to mortgage securitization, rates in cities as various as Chicago, San Francisco and Houston were "virtually identical."[9] Previously, higher rates in growing cities had made mortgages more expensive there. It was a matter of supply and demand in the local capital market. By the late 1970s, Fannie and Freddie enabled fast-growing cities to access the same mortgage rates as slower-growing cities. With billions of dollars of eastern and midwestern capital, Houston financial institutions were able to offer relatively cheap credit to developers to build more homes. Even after the oil bubble burst and Houston's economy fell into recession in the early 1980s, developers continued to build because the secondary market continued to provide cheap money.

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[8] FHLB, *Summary of Savings Accounts by Geographic Area,* (Washington, 1981), 21-23. All dollar amounts are in constant 2015 dollars unless otherwise noted.
[9] "Trading Home loans like bonds," *New York Times*, Jan 22, 1984.

Most Americans were unaware of the regional capital flow facilitated by Fannie and Freddie. The workings of the secondary market seemed to be shrouded in complexity. Grassroots groups like NPAH and their Congressional allies had sought to illuminate how the GSEs redlined on a metropolitan and regional basis. But proponents of mortgage securitization, like Rep. Harry Barlettt, a Republican representing Dallas' northeast suburbs, denied there was anything to fear from the secondary market. On the 15th anniversary of Freddie Mac's creation, Barlett told his fellow representatives that Freddie Mac was, in fact, "not some complex thing or entity. It is merely a chain—a linkage that runs from your local homebuyer through to your local depository institution, to your secondary mortgage market conduit like Freddie Mac and then to Wall Street. And everyone benefits along the way."[10] *Los Angeles Times* columnist James Flanigan agreed with Bartlett, writing that the "vast, swirling market in mortgage-backed securities" was nothing to be feared. In a piece carried by the *Houston Chronicle* in 1987, amidst the city's foreclosure crisis, Flanigan assured his readers that "the mortgage securities market is [not] a devilish invention that threatens to lead our credit system over a cliff." It was, instead, "a force for stability and safety in the important business of housing finance. Thanks to the mortgage securities market, there is more mortgage money available for home buyers now than in the old days when banks and savings and loan associations would simply stop making mortgage loans in a period of interest rate volatility such as the present."[11]

Houston's New Subdivisions

Two of Houston's largest developers during the 1970s were backed by oil companies, which owned vast tracts of land near Houston. The windfall from high oil prices and the high demand

[10] 131 Cong. Rec. H E3460 (July 23, 1985).
[11] James Flanigan, "Mortgages, Securities, higher rates related," *Houston Chronicle*, May 5, 1987.

for housing encouraged oil companies to enter the housing development industry. George Mitchell, whose oil company pioneered hydraulic fracturing, and Friendswood Development Corporation, which was a subsidiary of Exxon, built huge new subdivisions on the outskirts of the city. Like all other Houston developers, however, oil companies took advantage of the secondary market's growth during the 1970s. The emergence of the securitized home finance system did not create the concept of the suburban subdivision, but it did privilege certain forms of development and help to reproduce them on a mass scale. As it reproduced these patterns, it also changed them. The trend of building "new towns" as islands for the wealthy ended up producing an archipelago of struggling subdivisions for the middle-class.

Mitchell and Friendswood modeled their developments on the "new town" concept, an idea that had been widely discussed among urban planners since the 1930s and had gained national momentum in the 1960s.[12] The goal was to produce an entirely new community with all the amenities and services of a city that was therefore independent from existing cities. In addition to residential development, the developments also provided retail and office space so that residents would not have to leave the community for any of their day-to-day needs. The "new towns" built by Friendswood and the Woodlands provided a model for other developers. As developers of some of the most well-known and exclusive suburban communities in Houston, they helped to determine what made a community desirable.

The Woodlands, built by Mitchell Enerry & Development thirty miles northwest of downtown Houston, opened in 1974. Conceived as an "antidote to urban sprawl, " *The New York*

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[12] Nicholas Dagen Bloom, *Suburban Alchemy: New Towns and the Transformation of the American Dream* (Columbus: Ohio State University Press, 2001); Ann Forsyth, *Reforming Suburbia: The Planned Communities of Irvine, Columbia, and The Woodlands* (2005).

Times reported in 1981 that it had grown to become "a harmoniously landscaped assemblage of people, residential villages, schools, streets, parks, scenic vistas…office buildings… even skyscrapers."[13] It was part of HUD's New Communities Program, which was created by Congress in 1970 to encourage the growth of "new towns." As part of the program, the Woodlands received $300 million in federal loan guarantees and $120 million in federal grants in exchange for a commitment to provide mixed-income housing. Mitchell himself claimed that "social and economic variety" was part of his vision. By 1980, however, the median income in The Woodlands was nearly twice the national and Texas averages and non-Hispanic whites made up more than ninety percent of the total population.[14] The Woodlands was the only financially successful "new town" of the thirteen communities supported under the New Communities Program. Developers of the other twelve projects folded before they were completed. The Woodlands, however, thrived as an increasingly affluent, racially exclusive community. In 1983, the *New York Times* reported:

> a visitor gets the impression of a comfortable resort community. There are three 18-hole golf courses… Blond teenagers amble about the main hotel, a chalet-styled place, in tennis white and designer blue. A hostess at the bar, adjusting a sign to read 'Today's drink is strawberry daiquiri,' says about half the staff live outside The Woodlands.

Indeed, many of the workers who maintained The Woodlands could not afford to live in the government-subsidized development. Roberto Madrid, who mowed the grass along The Woodlands' roads, told the *Times*, "It's too expensive for me to live here… It's for the rich."[15] Even for those who could afford to live in The Woodlands, the "utopia" that they were sold had its problems. The Rev. Don Gebert, director of The Woodlands' Interfaith Center, noted in 1983,

[13] "2 Planned Towns Flourish in Laissez-Faire Texas," *New York Times*, Sep. 15, 1981.
[14] 1980 Census.
[15] "Distorted Dream," *New York Times*, Jan. 7, 1983.

"Everybody is transplanted from someplace else. There are no natives, no city fathers, no cadre of old-timers you can turn to, no set of traditions, everything has to be created."[16]

Subdivisions like the Woodlands seemed to be unmoored, island communities. According to the developers, residents had all they needed. Mitchell and Friendswood's developments were Houston's trendsetters in suburban development during the 1970s. Their developments and homes were larger and more expensive than their competitors, although they did contain a range of prices with some units attainable for the middle-class. On a smaller scale, hundreds of other subdivisions reproduced this design ideal. Importantly, developers promoted these communities as completely new. Newspaper articles, brochures and annual reports rarely made mention of communities that existed on or nearby the land where these subdivisions were built. Their names, such as Parkwood, Forestwood and Foxhollow, bore little, if any, relation to whatever communities pre-existed their development. Most often, they were built on farmland or forested land, far from towns and villages. When newspaper articles, real estate appraisals and developer brochures described the location of these places, they primarily mentioned the distance to downtown Houston, the quadrant of the county in which they were located and their relation to nearby freeways and shopping centers.[17] They rarely mentioned a nearby town or any municipality.

In these descriptions, gestures to place and history were confined to a limited set of abstract symbols, usually concerning the non-human environment. Subdivisions' names might make reference to the flora and fauna that occupied the surrounding area (e.g. Cypresswood). More often, the invocation of the environment was much more vague (e.g. Forestwood).

[16] "Houston Project," *Washington Post*, Feb. 19, 1983.
[17] From a survey of material on Houston development found in the Y. Frank Jungman Collection, Houston Metropolitan Research Center.

Kingwood, built in the heavily forested area northeast of Houston, used lumber in many of its residential and commercial buildings as a way to create a connection to its environment. These symbols described an environment without human history or political agency.

The cultural landscape promoted by Houston's homebuilding and home finance industries during the 1970s was significantly different from the one imagined earlier by their colleagues in California or Illinois. Those institutions, especially S&Ls, often embraced local history. They celebrated themselves as important local leaders and they tied themselves to powerful local mythologies. These historical ties were no more authentic than Houston developers' environmentalism. They often embraced exclusionary histories that celebrated male European-Americans and westward expansion while silencing other histories (see Chapter 1). But importantly, they did make a claim to human history and agency, even if gender, race, and class limited this agency. When neighborhoods suffered economic decline, residents could engage with these social histories, as they did when Chicago S&Ls began to relocate to the suburbs in the 1970s (see Chapter 4). They could reformulate them into politically powerful narratives about the historical and institutional causes of neighborhood decline. Residents of Houston subdivisions built with securitized capital did not have this ability, which left them with a radically new form of local-scale social and political alienation in the post-boom era.

Friendswood

Instead of a community based in history and place, Houston developers marketed "community" in the subdivisions they built and controlled as a consumer product created by the natural market outcome of supply meeting demand. The organic "orderliness" created by the market seemed to mirror the natural environment. Developers claimed that such "orderliness" created a stronger sense of “place” and “community” than the city. It meant order over social, environmental and cultural landscapes. It promised separation from the city’s fragmented politics—its racial, economic and sexual diversity and disorderliness. It also promised a safe, managed encounter with the “environment”: “reforestation” programs that planted trees throughout the neighborhood, manicured gardens, and quiet trails through the forest. Developers encoded these messages in a landscape of uniform cultural symbols of affluence, leisure and safety.

Friendswood was not part of HUD’s new town program but it did promote its communities as “new towns.” None of its developments were as large as The Woodlands, and because it did not receive HUD funding, it did not have a requirement to provide mixed-income housing. Thus, many of its developments were even more expensive than the Woodlands. Friendswood’s developments, scattered across northwest Houston, distinguished themselves from the city in terms of racial and class exclusivity. The census tracts that included Kingwood were more than 93 percent non-Hispanic white. The median income was well above twice the Texas and national medians.

The Friendswood Development Corporation 1972 *Annual Hi-Lites* annual report described its new development projects in dramatic prose:

> A quiet forest trail meanders through the woods, belying its location in the midst of a new residential community. Trailwood Village in the Kingwood Area…On the north bank of Cypress Creek, new homes spring up in their own forested setting, Cypresswood…Not far from the west shore of Clear Lake, construction of a new hospital pushes two circular towers skyward, and a building with half as many square feet as the Domed Stadium waits its finish to accommodate the bustle of high school students. Clear Lake City…The dawn’s first light produces a shimmering gold from the towers of almost $300 million worth of industrial plants. Bayport…These… are projects of Friendswood Development Corporation.[18]

[18] Friendswood, *1972 Annual Hi-Lites*, Box 11, Folder 11, Y. Frank Jungman Collection, Houston Metropolitan Research Center.

In Friendswood's telling, these developments seemed to spring forth organically out of their natural environment.

Friendswood offered its residents an environmental experience that promised to be both organic and controlled. The *1972 Hi-Lites* described the duality of this environmental fantasy. In bold, at the top of page four, was the heading "Ecology: The totality or pattern of relations between organisms and their environment," and then, below:

> Man, of course, is the controlling, most sophisticated of organisms. The environment is his ward, his responsibility.
>
> Between the extremes of these simple statements are the platforms of ecological and environmental debate.
>
> This is a report on the environmental maintenance activities of Friendswood Development Company.[19]

Following this dramatic introduction, an interview with President John B. Turner described Friendswood's "exceptionally important and active role… in the fields of ecology and environmental maintenance." Indeed, "in some cases," Turner reported, "we exercise a great deal of control over many elements of the environment." Recreational facilities, from a "walk in the woods" to "flower gardens," were prime examples of Friendswood's environmental "role." Friendswood even embarked on a "reforestation program." The program planted tens of thousands of trees, including one "in the yard of each new home." Turner acknowledged that some of these programs were "not reforestation in the strictest sense," but residents could still see a lot of trees, if not the forest.[20]

Turner admitted that it was not altruism that guided Friendswood. There were certain "financial advantages" in Friendswood's "attention to ecology." "Our premise has always been a

[19] Ibid.
[20] Ibid.

combination of good economics and good aesthetics," Turner said. "The buying public has… cast their votes for our premise." In Turner's telling, Friendswood's commitment to ecology and the environmental was a product of organic forces of supply and demand. It offered prospective residents the chance to experience the environment in a way that was both controlled—built on the "good economics and good aesthetics" of the company—and the natural coincidence of supply meeting demand.[21]

Friendswood also claimed to offer residents a political landscape that was "more orderly" and "more responsive." As "alternatives to… incessant single-city urban growth," Friendswood's developments were ostensibly independent from the political disorderliness of the city. The company claimed that this independence from the city provided residents with the opportunity to "become part of a more readily-identifiable community and have a stronger 'sense of place.'"[22] Turner's claim notwithstanding, what was missing from Friendswood's definition of the ideal community was any idea that humans gain a greater sense of place through dialogue with others, connection to the past and, indeed, in conflict with each other over the meaning of particular places. Implicit in Turner's words was a denial that community-building is a social process. Instead, for him, "place" was a ready-made consumer product.

Friendswood divided each of its "new towns" into a number of so-called "villages." The "new town" might have had a projected population of tens of thousands, but each "village, or subdivision" had a population of a few thousand or fewer. "Thus," Turner said:

> a major development becomes a series of smaller developments, each with its own identity, and it is this identity which has so much sociological significance… All of the

[21] Ibid.
[22] Friendswood, 1974 Hi Lites, 3, Box 11, Folder 11, Y. Frank Jungman Collection, Houston Metropolitan Research Center.

> elements of the new town resident's life can be within his own well-identified town, if the resident so chooses. The important point is: He has a choice.
> Living in a village within a new town satisfies the much talked about longing for a 'sense of place' and recognition within one's own community.

When Turner's "interviewer," wondered whether such "crisply efficient planning tend[ed] to impose a degree of regimentation on… residents," Turner claimed, "the reverse… is true. Proper planning can free people of regimentation of the sheer mass or urban growth." A prime example was the "freedom of time" that Friendswood provided. Instead of driving long distances to recreational facilities, shopping or other amenities, residents could find them within their own "villages."[23]

For Friendswood, "freedom" and "community" were consumer products ensured by corporate planning and market efficiency. All cities and towns made plans and adapted them to fit changing needs, Turner acknowledged, but "new town" developments were able to apply planning more effectively. Their communities were smaller than large cities and the company controlled all planning within these "more manageable areas" without having to "contend with the burden of large populations." Instead of the democratic messiness of large cities, market demand guided the developers planning programs, according to Turner. Residents "voted with their feet," by deciding to buy a home in Friendswood's developments. "The end result," Turner said, "is a better product for the consumer, which boils down to a better place to live."[24]

Kingwood, the "livable forest," as Friendswood described it, was located in the piney woods northeast of Houston. The *Ladies' Home Journal* named it one of "America's Best Suburbs" in 1975 and approvingly noted the "commercial areas are of rough-hewn lumber construction, residential in character, and landscaping is exquisite." The *Golf Course Designer*

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[23] Ibid.
[24] Ibid., 4.

named the sixth hole at Kingwood Country Club “the hole of the year,” praising it as “natural looking, panoramic, challenging, tree-bordered, beautiful and most intricately designed.”[25] That the hole could simultaneously be “natural looking” and “intricately designed” highlighted the way that the landscape itself had been commodified. Golf holes could take on a life of their own.

Homeowner Associations

The developers of Houston’s new subdivisions claimed their private homeowner associations gave residents a more responsive political apparatus than actual municipal governments. Membership in these associations was mandatory for homeowners, mandated by deed restrictions written by developers. Residents were required to pay membership fees to the association. Deed restrictions could also contain numerous restrictions on homeowner rights, stipulating what color owners could paint their houses, what they could plant on their lawns, and even what kind of curtains they could use in their windows. Deed restrictions could even require that association safety inspectors enter a home if the association suspected a safety problem. If homeowners violated these rules, associations could charge fines. A 1987 Texas Supreme Court decision gave associations the power to foreclose on homeowners who failed to pay their association dues.[26]

These associations provided services that were the responsibility of local governments in most places. They were responsible for maintaining common areas. They paid for street lighting and garbage collection. They organized security patrols. And Houston’s lack of any zoning

[25] Friendswood, 1975 Hi Lites, 3, Box 11, Folder 11, Y. Frank Jungman Collection, Houston Metropolitan Research Center.
[26] Inwood North Homeowners' Association, Inc., Petitioner, v. Charlie Harris, Jr., et al. and Rolando M. Pamilar, et al., Respondents, 36 S.W.2d 632; 1987 Tex. LEXIS 380; 30 Tex. Sup. J. 584.

regulations meant that private associations were often the only entity with an ability to control development. Without active homeowner associations, there was nothing to stop a business from operating in a previously residential neighborhood.

In these private associations, only homeowners had a political voice, which tended to privilege male breadwinners. The associations allocated votes to households rather than to all individual adults, reinforcing patriarchal family structures. Women, of course, inserted themselves into association politics and many husbands, no doubt, happily left association duties up to their wives. But, in terms of voting, married women had no political voice independent from the household. Neither did men. But assuming that male-dominated households vastly outnumbered female-dominated households, the one-homeowner-one-vote system, more often than not, worked to strengthen patriarchy. Thanks to a vast array of government and industry policies, the majority of homeowners in these subdivisions were married couples and of the non-married, single women were much less common than single men.

In basing voting rights on ownership, these associations produced an electoral system that seamlessly converted capital into political power. Any renters that found their way into these subdivisions were excluded from association voting rights. People or businesses that owned multiple homes controlled multiple votes within the association. Indeed, by this mechanism, developers and homebuilders often maintained significant political power in these subdivisions. They usually owned the surrounding land and controlled its development. They also maintained significant, sometimes dictatorial, power within homeowner associations. Developers wrote the deed restrictions that governed the association and they made sure to require that the association remain under their control until a supermajority of lots were sold to residents. Developers usually relinquished control only when three-quarters of the lots were sold.[27] For many subdivisions this meant years of living under a quasi-municipal government that was controlled by private developers without any participation of local homeowners. Undeveloped lots and unoccupied homes provided developers with votes on the association board with reduced membership fees (which developers justified with the argument that they were not using the subdivision's common areas). Sometimes, developers could annex a new, undeveloped piece of land to the subdivision and thus prolong their control of the associations. Financial institutions also held votes corresponding to the foreclosed homes they owned in each development.

In 1987, the Texas Supreme Court added to the power of homeowner associations in *Inwood North v. Harris and Pamilar.*[28] The Court ruled that homeowner associations could foreclose on members who failed to pay dues. It was a surprising decision. Texas' constitution seemed to clearly limit the type of creditors that could foreclose on a home:

> The homestead of a family, or of a single adult person, shall be, and is hereby protected from forced sale for the payment of all debts except for the purchase money, the taxes due thereon, or for work and material used in constructing improvements thereon.[29]

Judge Oscar Mauzy in his dissenting opinion argued that the "matter [was] as clear and bright as the Texas sky at night": homeowner associations did not meet any of the clear criteria of the homestead exemption and should not be allowed to seize the homes of their debtors. Yet, the majority of the court held that associations did indeed have the right to foreclose on homeowners who failed to pay membership fees. Because the covenants that required membership preceded the land becoming a homestead and thus became an "inherent characteristic" of the property,

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[27] "Role of Community Associations Widens," *New York Times*, Aug. 25, 1976.
[28] Inwood North Homeowners' Association, Inc., Petitioner, v. Charlie Harris, Jr., et al. and Rolando M. Pamilar, et al., Respondents, 36 S.W.2d 632; 1987 Tex. LEXIS 380; 30 Tex. Sup. J. 584.
[29] Tex. Const. art XVI, ß 50.

Judge Ted Robertson wrote in the majority opinion, the homestead exemption of the Texas Constitution did not apply. Texas was not alone. In their opinion, the Texas justices cited several other cases, all from southern states, which similarly granted homeowner associations the right to foreclose on delinquent members. Few, if any, Houston associations actually foreclosed on delinquent members, but the threat of foreclosure was now an effective tool for associations to use.

Financial Institutions in Houston's New Subdivisions

For decades, bank and thrift buildings had been the most prominent structures in many American towns and cities. Located at the urban center, often at the most highly trafficked intersection, their size and ornate features conveyed power and prestige. They symbolized the wealth and influence of the community and especially its elite. Even during the early postwar era of suburbanization, new bank and thrift buildings were often similarly prominent. Yet, even as these grand structures conveyed power, they also articulated the idea that financial institutions served a special function in their communities. They, more than other businesses, seemed to be firmly grounded in place. For those that had grievances with financial institutions, these buildings presented a clear target. Protestors knew where to go and to whom to complain.

In contrast, the bank and thrift buildings constructed in Houston during the 1970s masked the power of finance. They blended in with the surrounding landscape. They were in malls, grocery stores and next to gas stations. Sometimes, as in Kingwood, these commercial developments were designed to look residential in character. In other developments, they occupied anonymous, modernist office towers—shiny rectangles of metal and glass, like the Skidmore-designed Westchase National Bank Building on Houston's Westside. Bank and thrift buildings no longer stood apart in the physical landscape. They were not as readily identifiable. If residents had a problem with these institutions, they had difficulty finding them. When they did, picketing did not have the same effect as when financial institutions stood at the center of the community.

Financial institutions became more like other businesses not just in their physical presence, but under new financial regulations. As policymakers and regulators liberalized branching rules and supported a drastic consolidation of the industry, bank offices were much more likely to be branches of a chain rather than home offices. Like other retail outlets, they offered a range of consumer products in convenient styles. Even when bank buildings could be seen, they were not as closely identified with their particular locale or special function as financier to the community.

"Two Cities"

Houston's boom created new patterns of segregation. African Americans, Chicanos and Anglos alike—including many migrants from northern and western cities—moved to new developments on the city's periphery. But broad patterns of systematic discrimination provided uneven access to suburban homeownership and produced a dichotomous racial landscape. The city's western suburbs were predominately Anglo, while eastern suburbs were home to many majority-black and Chicano communities, including many dominated by suburban apartment complexes. Financing was easiest to obtain in the west. It was also where the best land for large-scale suburban development was located. In contrast to the forested northeast and the swampy southeast, the west was relatively flat, dry and treeless agricultural land that could be developed more cheaply than eastern areas. In contrast, East Houston was home to many industries, especially along the shipping channel to the Gulf, and it had higher levels of air pollution than West Houston. In 1978, Robert Moore, the director of the city's housing authority, told a Congressional hearing on homeownership, "we have become almost a divided city, between the east and the west—the west being predominately white, upper to middle income; the east being predominantly black, and Mexican-American low to moderate income—in effect, two cities." On a local level, highways and "armpit shopping centers" often served as color lines.[30]

Meanwhile, Houston's boom masked problems in the urban core, which continued to be majority non-Anglo except for a few wealthy enclaves. While Houston developers were building homes by the thousands in the western suburbs and the overall housing stock increased, communities located near the urban core were losing housing. As developer David Sawyer told the committee "the urban decay of Houston is veiled by its prosperity." Houston had "plenty of urban decay," Sawyer said, but it was "not obvious… because Houston has the ability to annex land within its extraterritorial jurisdiction and, in fact, as a consequence, to prevent the fiscal flight, if you will, of the affluent population." The effect of annexation, Sawyer said, was to make it "politically much easier for our city government, our mayors, our officials to avoid facing up to the challenge confronting what I think are potentially deadly issues."[31] Indeed, annexation allowed businessmen and public officials to claim that Houston did not face the same urban problems as northeastern and midwestern cities. Annexing wealthier areas increased city revenue and bolstered wealth and income statistics. But this did not mean that city officials redistributed tax revenues to poorer areas. Instead, annexation only contributed to inequality. For

[30] *Homeownership Task Force: Hearings Before the Subcomm. on Housing and Community Development of the Comm. on Banking, Finance and Urban Affairs, House of Rep., Part 1*, 95th Cong. 620 (Jan. 24, 1978) (Statement of Robert Moore, director of the Houston Housing Authority).
[31] Ibid., 659 (Statement of David Sawyer).

example, the GSEs used Houston's sprawling municipal boundaries to increase the number of "urban" mortgages they held (a demand of HUD under Patricia Harris). They bought mortgages in outlying city neighborhoods that were only nominally urban. They looked like suburbs and were mostly white and upper-middle-class, but technically, they were urban.

Financial institutions were reluctant to finance building on the city's east side. One local builder, Tyler Todd of Village Developers, told the committee that "if I want to put a subdivision in on the east side, and I wanted to do it the same as I do on the west side, it would be almost impossible because I could not get the financing." Democratic Representative Les AuCoin (Oregon) asked Todd if this amounted to "redlining." Todd responded that it did "in a sense but they will do it anywhere from New York down to local areas. It is just that everybody has heard that Houston is developed west, so if you come in with a project on the west side you are going to get the money; if you come in on the east side, you are not going to."[32] It might not have been traditional redlining as Todd understood it. But whether local financial institutions were refusing to lend in minority areas or New York investors were only interested in the majority-white Westside, the effect was the same.

No one seemed able to identify the people responsible for the racial divide. The denial of human agency in the place-making of Houston's subdivisions worked against those that campaigned for racial justice. As a commodity rather than a social process, Houston's subdivisions veiled the institutional causes behind racial disparity. In a 1980 study of the Houston housing market, Texas Southern University sociologists Robert Bullard and Donald Tryman argued, "discrimination in housing has reached a level of sophistication that makes it

[32] Ibid., 631 (Statement of Tyler Todd).

easy to practice but difficult to 'prove.'"[33] African Americans who moved to Sun Belt cities hoping to "escape" the stark segregation of northern cities were "finding out that housing segregation and housing discrimination exist in these 'new' cities as in the areas they left," Bullard and Tryman wrote. Local lenders, realtors and developers pled innocence to charges of racial discrimination; they were merely following the market, they said, building where land was cheapest and financing most easily obtainable. The city's Fair Housing Division was created in 1975, eight years after the 1968 Fair Housing Act, but it was woefully ill-equipped to enforce non-discrimination laws.[34] The division received complaints and facilitated negotiations but did not have any legal staff to pursue litigation.

Houston's housing boom was also marked by class differentiation. The average price for a new home in 1977 was $217,000 and only five percent were below $155,000, well above what the working-class could afford. The price boom was not just in new housing construction. Between 1972 and 1977, the average price for a used home jumped from $120,00 to $205,000. "Despite a growing housing stock," the director of the city's housing authority, Robert Moore reported, "an increasing number of Houstonians are not being served by the market—that is, the "trickle down" theory of housing is not working here in Houston."[35] At these prices, almost 60 percent of Houston residents could not afford to buy a home, Moore reported.

[33] Robert Bullard and Donald Tryman, "Competition for Decent Housing," *Journal of Ethnic Studies* 7:4 (Winter 1980), 51.
[34] Robert Bullard, *Invisible Houston: The Black Experience in Boom and Bust* (College Station, Tex.: Texas A&M Press, 1987), 54-55.
[35] *Homeownership Task Force*, 620 (Statement of Robert Moore).

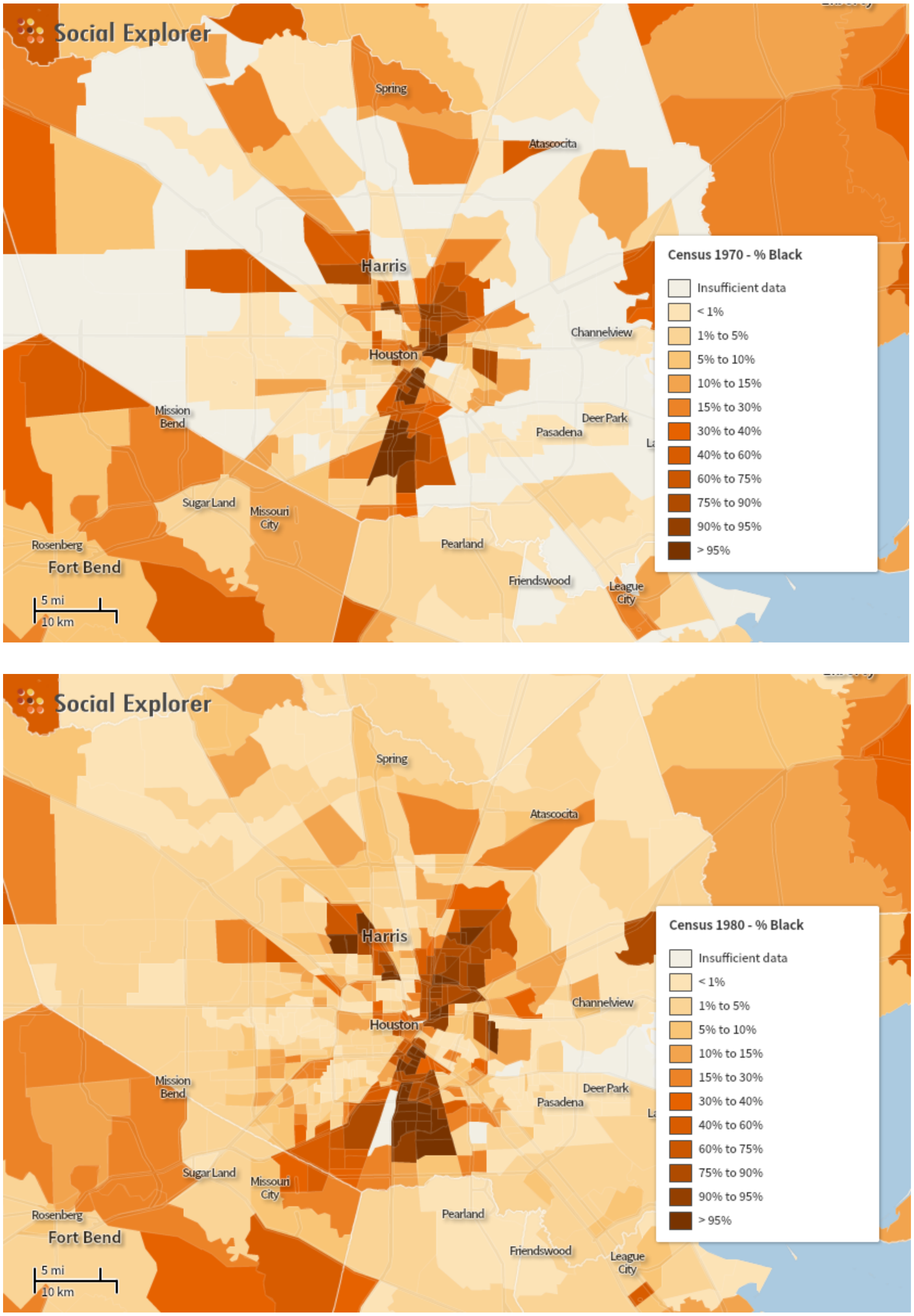
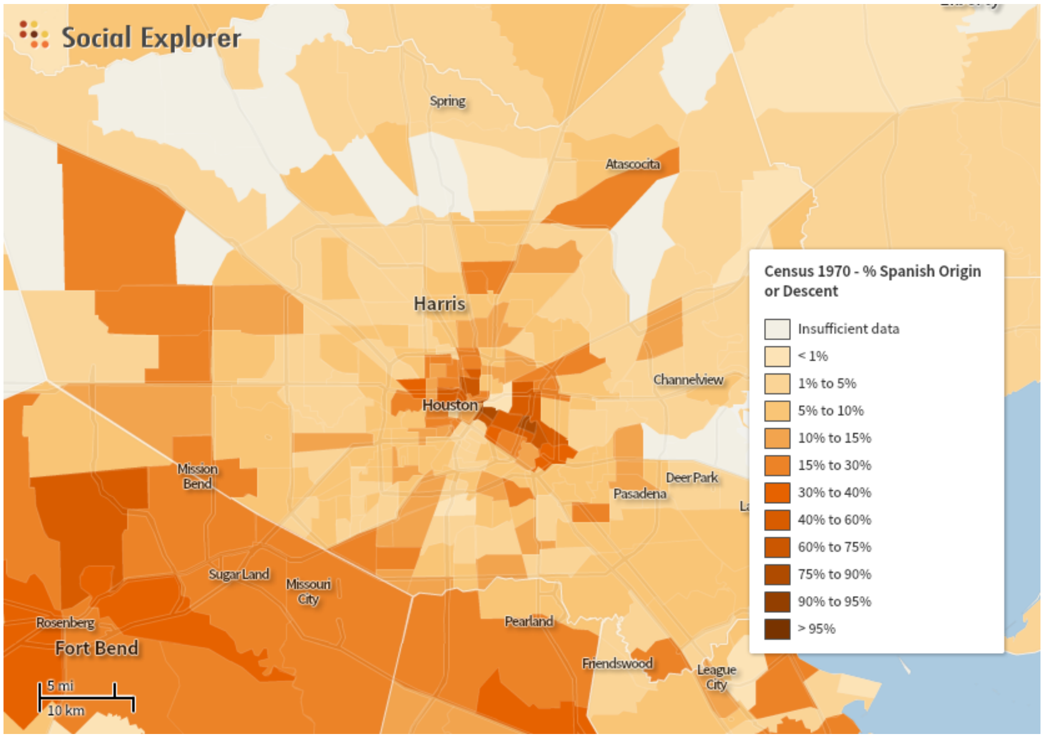


Figure 6.3. Houston African American Population in 1970 and 1980.
Source: Black Population, 1970 and 1980, Social Explorer (based on data from U.S. Census Bureau; accessed Dec. 2, 2013).



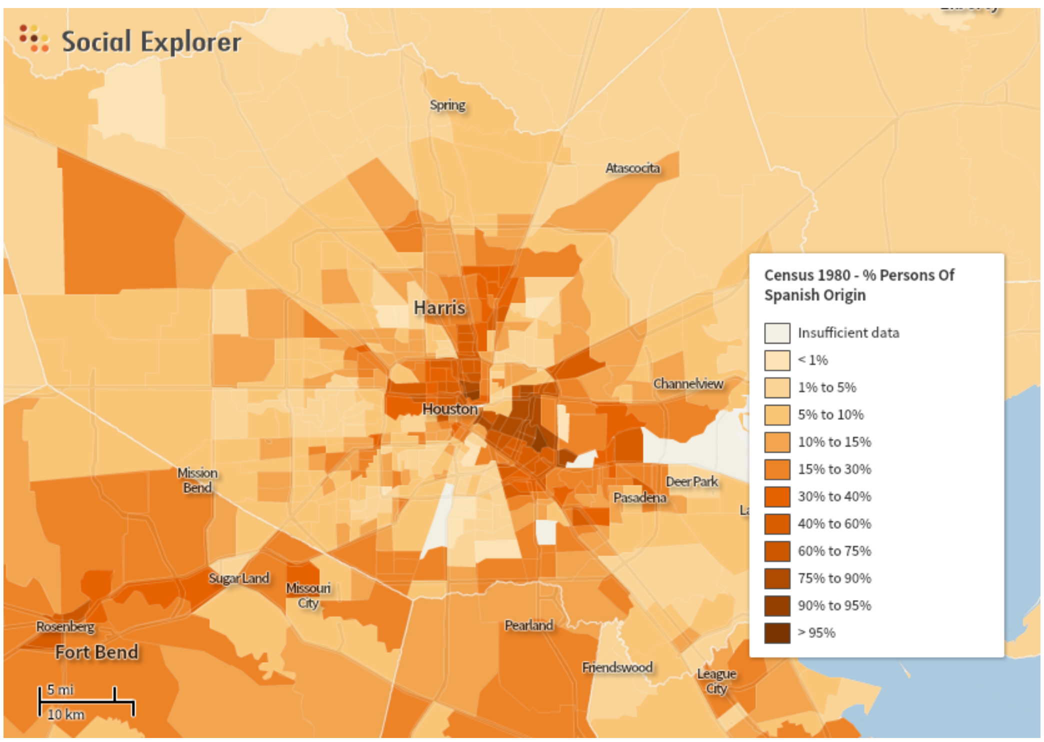


Figure 6.4. Houston Latino Population in 1970 and 1980.
Source: Spanish Origin Population, 1970 and 1980, Social Explorer (based on data from U.S. Census Bureau; accessed Dec. 2, 2013).

"Suburban Slums" and "The Foreclosure Rainbow"

In 1985, the first wave of mass foreclosures hit Houston. What was most striking to many commentators was that the crisis hit not only lower-class urban areas but also middle-class subdivisions, including many on the west side, which had been the fastest-growing region in the metropolitan area. The arc of land from Houston Intercontinental Airport in the north to Missouri City in the Southwest became know as the "foreclosure rainbow," an eight-mile wide strip of land containing hundreds of subdivisions built during Houston's boom. The wave of foreclosures in white, middle-class suburbs caught the attention of the national media. The *Los Angeles Times* dubbed Houston "Foreclosure City, U.S.A."[36] The *Wall Street Journal* reported that many subdivisions threatened to become "suburban slums." The *Journal* cited Ashcreek as one example. Ashcreek was brand new. It opened in 1984, but only a year later, homeowners began to default. Home values fell by more than half in some cases and "by 1986, the neighborhood was pockmarked by overgrown lawns and rusted for-sale signs." "Fear and resentment linger among those who have been left behind," the *Journal* reported. Barton Smith, an economist and director of the University of Houston's Center for Public Policy, compared foreclosure-ravaged subdivisions to "war zones." After years of housing shortages, Houston now faced a vacancy problem: in some neighborhoods, more than half of the homes had been foreclosed; one in six homes in the metro area were vacant.[37]

The foreclosure crisis was unequally distributed. Wealthier communities backed by large developers that had weathered the recession and were still active in maintaining the community were better off. Often, these wealthier subdivisions were part of large, master-planned

[36] "Houston—Foreclosure City, U.S.A.," *Los Angeles Times*, Oct 21, 1985.
[37] "Suburban Blight," *Wall Street Journal*, Feb 5, 1987.

communities, like Kingwood, that included several subdivisions along with retail and office space. One example was Friendswood's Copperfield development in northwest Harris County—a "pot of gold in the 'foreclosure rainbow,'" the *Chronicle* called it. Copperfield opened in 1979 and by 1986 it included 2,400 homes, with plans for 1,170 more. Homes there were still selling in the five "villages" which made up the development. Barton Smith described the appeal of these communities: "Where builders are still active, in the master-planned communities like Copperfield and First Colony, there is a demand for the security these subdivisions offer." In 1986, resale prices in master-planned communities had fallen 20 percent from 1983; in communities without master planning, prices had fallen 40 percent.[38]

Seeds for a homeowner movement?

The boom and bust of Houston's real estate market meant that by the 1980s many subdivisions were left half-empty, their associations still in the hands of developers. Many of these developers went bankrupt in the 1980s, leaving defunct homeowners' associations in their wake. Homeowners faced significant legal obstacles in reestablishing these associations without the developers. Many of the homes in these developments had been foreclosed, leaving their ownership and their association votes in the hands of financial institutions. Financial institutions, many of which were themselves facing failure, often had little interest in revitalizing homeowner associations. Moreover, remaining homeowners often did not know which financial institution or developer owned empty homes in their neighborhood. In a political system based on real estate ownership, a foreclosure crisis was crippling.

The regional economic crisis fueled broad discontent in Houston's suburbs, including frustration directed at homeowners' associations. The Silvermill, on Houston's far west outskirts

[38] "Development a pot of gold in the 'foreclosure rainbow,'" *Houston Chronicle*, Aug. 3, 1986.

was one example. For association elections, the developer gave itself three votes for each undeveloped lot while homeowners each got one vote. Deed restrictions held that homeowners would assume control of the association only when seventy percent of Silvermill's lots were sold. Like many subdivisions, this ratio was not met before the foreclosure crisis of the mid-1980s. In 1988, Silvermill's developer, General Homes, still held three of the five positions on the Board of Directors while only contributing $40,000 to the association's $167,000 annual budget.[39] General Homes claimed that the lower membership fees were justified because it paid the initial cost of constructing common amenities and, unlike homeowners, it did not make any demands on them. Meanwhile, during a time when Houston residents were trying to make do with less, many associations, facing their own budget shortfalls, raised fines on violations of subdivision rules.

Developers like General Homes faced a potential revolt from homeowners. According to Silvermill resident Leonard Sachs, the developer-controlled association amounted to "taxation without representation." "This is supposed to be a homeowners' association but the homeowners have nothing to say about it,'' Sachs told the *Chronicle*. Sachs circulated a petition to suspend payments to the association. Across the metropolitan area, thousands of homeowners were refusing to pay association fees whether by choice, economic need or a combination of the two. In many associations, the delinquency rate was as high as 50 percent.[40]

Proponents of homeowner associations defended them as vital to the "integrity" of subdivisions and dismissed frustrated homeowners as ignorant or even mentally ill. "These days people in condos and subdivisions are all bitchin'," attorney Richard C. Lievens, former

[39] "Homeowner Groups Facing Tough Times," *Houston Chronicle*, Jan. 17, 1988.
[40] Ibid.

president of Houston chapter Community Associations Institute, claimed in 1988. Responding to the complaints that associations wielded too much power, Lievens was defensive: "There's nothing illegal about it." Another former Condo Association President, Sam Turner, thought homeowner complaints were evident of mental illness. "In any association of 200 or more people you're going to have a couple of manic depressives or schizophrenics or perverts," he said.[41] Turner was also a volunteer in Houston Proud's new Adopt-a-Subdivision Program.

Adopt-a-Subdivision

In 1986, the Houston Economic Development Council, which represented the city's business community, created the "Houston Proud" Campaign to revitalize the damage done to Houston's image during the recession. Modeled on New York City's "I ♥ NY" campaign, its programs included marketing and advertising, beautification projects, civic events, and speaker series. But, Houston Proud's activities extended beyond these traditional elements of civic boosterism to more directly respond to the growing unrest in Houston's "foreclosure rainbow." Foreclosed homes and subdivisions falling into disrepair endangered Houston's reputation of endless opportunity fostered by free markets. Defunct homeowner associations couldn't keep the lights on, the pool clean or the grass mowed.

The business leaders of Houston Proud sought to reinforce Houston's system of homeowner-association governance. They eagerly embraced the work of professors at the University of Houston's School of Public Policy, who argued that neighborhoods with active homeowner associations better weathered the foreclosure crisis. Properly functioning homeowner associations were vital to subdivisions, Houston Proud leaders argued. They were

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[41] Ibid.

“quasi-municipal governments,” noted Houston Proud leaders.[42] Without homeowner associations, subdivisions lacked basic government services. The Neighborhood Revitalization Program set out to use business charity and government funds to reinvigorate Houston’s homeowner associations. Co-sponsoring the program were industry groups: the Community Associations Institute, the Houston Builders Association, the Houston League of Savings and Loan Associations, and the Houston Mortgage Bankers Association; professional associations: the Houston chapter of the American Institute of Architects, the Houston Bar Association, the Houston Board of Realtors, and the Houston chapter of the National Association of Accountants; and government agencies and government-supported corporations: HUD, Fannie Mae, the VA, and the City of Houston’s Department of Planning and Development. Its advisory council included financial executives from Houston S&Ls, banks and mortgage companies as well as city council members and a representative from Fannie Mae. Financial institutions provided the bulk of donations that funded the program in addition to volunteers.[43]

The program had “four key elements”: “continuing education” would provide associations with professional advice from realtors, accountants, lawyers and bankers, “corporate support” would provide corporate contributions which matched money raised by associations, and “communications” would provide subdivisions with regular newsletters. The program’s centerpiece was called “Adopt-a-Subdivision.” Houston businesses—mostly financial institutions, homebuilders, and realtors—would “adopt” subdivisions that had been orphaned in the crisis. The program’s goal was to re-establish homeowner associations and, more broadly,

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[42] Jenny Laminack and Susan Hill (Houston Proud), *Neighborhoods in Recovery—Three Cases Studies*, April 1988, Folder 17, Box 63, Eleanor Tinsley Papers, Houston Metropolitan Research Center.
[43] Memo, Susan Hill to Fund-Raising Committee, Sep. 10, 1987, Folder 17, Box 63, Eleanor Tinsley Papers,, Houston Metropolitan Research Center.

local business involvement. They would provide money and volunteers to reorganize defunct associations and make them more efficient.[44]

In response to the wave of frustration and discontent sweeping through Houston's subdivisions, the Adopt-a-Subdivision Program was relentlessly cheerful. Amid a regional recession, numerous job losses, widespread foreclosures and dropping home values, the program claimed that the power to make a meaningful change lay in the hands of subdivision residents themselves. "All it took was people, a good idea, hard work and… Houston Proud," program literature claimed. Jenny Laminack, a program volunteer and president of a local real estate consultant firm, described Adopt-a-Subdivision a "self-help program." The key was changing the attitudes of individual residents, cultivating a sense of "pride" and "confidence." Houston Proud volunteers, according to Laminack, gave residents a "new fresh hope" and a "cheerleading attitude of 'oh, let's do something' and 'yes, you can.'"[45] "Call them cheerleaders, Pollyannas, cockeyed optimists, and they grin," reported the *Houston Chronicle*. "The people are the heroes," Laminack said.[46]

This message of empowerment was appealing to many Houston residents who felt powerless in the face of the region's economic decline. The causes and villains of the crisis often seemed hopelessly beyond their influence. The precipitous drop in global oil prices had ignited a regional recession. Meanwhile, the risk-taking of local business during the boom years left many Houston residents stranded in a landscape of unfulfilled promises. The boom had given way to massive layoffs, empty office parks, uncompleted developments, and foreclosed homes. Risk-

[44] *Houston Proud Annual Review 1986-1987*, Folder 17, Box 63, Eleanor Tinsley Papers, Houston Metropolitan Research Center.
[45] Houston Proud Annual Review, 1987-1988, Folder 17, Box 63, Eleanor Tinsley Papers, Houston Metropolitan Research Center.
[46] "The Proud Crowd," *Houston Chronicle*, Jan. 6, 1987.

taking, corruption and mismanagement by business leaders had left a trail of neglect and bankruptcy.

Homeowner empowerment, funneled through business-sponsored homeowner associations, redirected residents' discontent toward responses that were acceptable to business interests. "Adopt-a Subdivision will not do some things," a program outline warned. "The team will not place volunteers in situations where disgruntled residents want conflict resolution among themselves, their neighborhood organization, their developer, etc. The team's purpose is to educate and to motivate in a positive way. It does not exist to referee or point fingers and place blame."[47] It was an intelligent strategy especially given the fact that many residents might blame the bankers, realtors and developers that now "sponsored" their communities.

More broadly, the program sought to dampen the crisis' potential for class and racial conflict. The economic recession and foreclosure crisis disproportionately affected the less affluent and people of color. Class and racial segregation between subdivisions created potentially fertile ground for homeowner movements that connected local grievances to broader issues of racism and inequality. But Houston Proud volunteers often stepped in before such movements could take shape. One example was in a subdivision called Fox Hollow, in far northwest Harris County, just south of The Woodlands. Fox Hollow was upper-middle class, with large lots and homes. Just across the street, the same developer built Fox Hollow West, a lower-middle class development with a higher density. When Houston Proud volunteers arrived on the scene, they found significant "enmity between the two subdivisions, which are roughly the same size but built for quite different economic 'classes.'" Volunteers set out to diffuse the

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[47] Jenny Laminack and Susan Hill, *HP Neighborhood Program, Business Plan and Operating Guide, 1987-88*, Folder 17, Box 63, Eleanor Tinsley Papers, Houston Metropolitan Research Center.

conflict. After meeting with residents, the two subdivisions agreed to engage in a "joint clean-up and beautification campaign."[48]

Houston Proud also used colorblind language to describe troubled subdivisions. Race was rarely mentioned. Sociologist Robert Bullard, in his book *Invisible Houston*, argued that Houston Proud was yet another instance of Houston's white establishment making African Americans invisible.[49] African Americans were not entirely invisible in Houston Proud literature. Brochures often contained images of black Houstonians, especially in interracial groups of children.[50] These interracial images in combination with text that never mentioned race were a powerful denial of racism's importance in shaping the housing market. Program literature conveyed the idea that Houston Proud was achieving racial harmony in Houston's subdivisions.

Houston Proud wasn't just about homeowner empowerment, it was also about business empowerment. Houston Proud called itself a "grassroots economic development campaign."[51] However, its roots lay in the city's business elite, including many of the financial institutions that were partly responsible for the area's housing bubble. Industry money and volunteers made the program possible and shaped its objectives. Indeed, Houston Proud's message was often one of business empowerment disguised as self-empowerment. Houston Proud literature spoke to two different audiences: homeowners and business sponsors. Its promotion of self-empowerment could be read either as a story of grassroots change among homeowners or a celebration of Houston's business elite. Houston Proud's 1987-1988 Annual Report conveyed this dual message. On the cover was a photo of Houston's San Jacinto Monument, a 567-foot column

[48] *Houston Proud Neighborhood Program, Highlights, February 1988,* Folder 17, Box 63, Eleanor Tinsley Papers, Houston Metropolitan Research Center.
[49] Robert Bullard, *Invisible Houston: The Black Experience in Boom and Bust* (College Station: Texas A&M University Press, 1987) 7-8.
[50] *Houston Proud Annual Review, 1987-1988,* Folder 17, Box 63, Eleanor Tinsley Papers, Houston Metropolitan Research Center.
[51] Ibid.

topped with a gigantic star, which commemorated the decisive battle in Texas' war of independence—a towering symbol of Texas' white male elite. Below was the text, "You shared the pride, now share the glory." Inside, Houston Proud President Millie Cowen expanded these remarks: "Just take a look at what we've done and you'll know there's nothing we can't do. Houston Proud is here to stay. And it's all thanks to you. You shared the pride, now share the glory." Cowen's "we" and "you" were both individual homeowners and business elites. Indeed, Houston Proud's literature told a story of the power of individuals aided by "positive attitudes" while also documenting the support of local business elites: "All it took was people, a good idea, hard work and… Houston Proud," according to Jenny Laminack. As one local realtor told the *Houston Chronicle*, "Houston Proud has united the private business sector. We're united as a team, out there to bring back the city that made us."[52]

Orphaned Communities

The first subdivision Houston Proud "adopted" was Forestwood, located on the northwestern outskirts of Houston. Built during the boom years of the late 1970s, Forestwood was, according to a local reporter, "ambitiously mis-titled. Despite that redundantly arboreal name, there are precious few trees in Forestwood. It's little more than a cluster of tract houses on a section of land scraped flat by bulldozers and planted over in St. Augustine [grass]."[53] Forestwood's developer controlled its homeowner association, like most new subdivisions. Homeowners would assume control once most of the lots were developed and sold. But, for years, that never happened. After the original developer went bankrupt, another developer took over. Before long,

[52] "The Proud Crowd," *Houston Chronicle*, Jan. 6, 1987.
[53] "Forestwood Reborn," *Houston Post*, Mar. 20, 1987.

the new developer went bankrupt too. The homeowner association, never having actually involved homeowners, went defunct along with the developers.

When Houston Proud volunteers arrived in Forestwood in May 1986, "they found a subdivision with almost every problem that could be imagined… vandalized homes, overgrown vacant lots, untended common areas, and a community pool that had been closed for months." Ninety-four of the 135 houses in Forestwood were vacant. The streetlights were off because the homeowner association was defunct and didn't pay the electric bill. "Yards grew into jungles," the *Wall Street Journal* claimed.[54] "Forestwood residents weren't 'neighbors' anymore, just fellow victims," the *Houston Post* reported.[55]

Houston Proud mobilized corporate charity, money and volunteers, to revitalize the homeowner association. They recruited an attorney to reorganize the association. A local title company provided information on the ownership status of the neighborhood's homes. With this information, volunteers were able to track down the absentee owners of vacant homes and undeveloped lots. They discovered that an S&L called Aztec owned almost all of the undeveloped lots. Houston Proud volunteers and homeowners then convinced Aztec to support the reorganization of the homeowner association and appoint a representative to the association's board of directors. Meanwhile, North American Mortgage Company, which held some of the foreclosed homes in the neighborhood, opened one of these homes to association meetings and provided "refreshments to neighborhood social events."[56] Incidentally, one of North American's

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[54] "Suburban Blight," *Wall Street Journal*, Feb 5, 1987.
[55] "Forestwood Reborn," *Houston Post*, Mar. 20, 1987.
[56] *Houston Proud Annual Review, 1987-1988,* Folder 17, Box 63, Eleanor Tinsley Papers, Houston Metropolitan Research Center.

Senior Vice Presidents served as Adopt-a-Subdivision's chairman, and North American contributed to the program's operating budget.[57]

With these businesses' help, the program was able to resurrect the homeowners' association. The pool was cleaned, the common areas maintained, flowers planted, deed restrictions enforced, and the precipitous decline in home values and increase in vacancies ameliorated. Perhaps the most important moment came when the streetlights came back on. "I remember the night the lights came back on," a resident recalled, "It was January 21st. Man, people, were coming out of their houses standing in the street and looking up like it was some kind of miracle or something."[58]

Another adopted community was Parkwood East. It sat just outside the northeastern edge of the city, in an area that was majority black. In the 1980 census, its census tract was more than two-thirds black and by 1990 it was more than eighty percent black. Development began in the mid-1970s. Many of the lower-middle-class residents worked in nearby oil fields. By 1986, almost forty percent of its 578 homes were unoccupied.[59] It faced similar problems as Forestwood. The homeowner association was victim to embezzlement by former leaders and bills for basic community services went unpaid. Residents first became aware of potential problems in the association when the street lights went out. As Jodie Baines, a resident of Parkwood East, told the *Chronicle*, "The spirit of our neighborhood was zapped. We had been ripped off, foreclosed on and no one was moving in… Then the burglaries started. It was

[57] Jenny Laminack and Susan Hill, *HP Neighborhood Program, Business Plan and Operating Guide, 1987-88*, Folder 17, Box 63, Eleanor Tinsley Papers, Houston Metropolitan Research Center.
[58] "Forestwood Reborn," *Houston Post*, Mar. 20, 1987.
[59] Houston Proud Annual Review, 1987-1988, 4, Folder 17, Box 63, Eleanor Tinsley Papers, Houston Metropolitan Research Center.

pathetic. A group of us got together to talk about it, but we just didn't know where to turn."[60] In 1983, appraisers had valued Baines' home at $230,000. In 1987, it was reappraised at $66,000. After seeing a Houston Proud advertisement, one resident suggested calling the organization. As in Forrestwood, the Adopt-a-Subdivision program revitalized the homeowners association, inspiring "a new feeling of energy and hope." One of its crowning achievements was the construction of "security fence" with financial support from Home Savings, which owned many of the foreclosed properties in the subdivision.[61] Neither Houston Proud literature nor newspaper coverage mentioned that Parkwood East had a significant black population. Jodie Baines, who was African American, became active in Houston Proud's campaign in Parkwood. The organization's 1988 Annual Review featured a picture of her and Jenny Laminack, who was white, possibly as a way to emphasize the interracial make-up of the organization.[62]

The Southwest Plan and Houston's New Financial Landscape

When Couch Mortgage Company failed, the effects spread to the Houston financial institutions that purchased its mortgages. It was just one of many cases of fraud, an extreme instance of the pervasive risk-taking that grew out of a regional boom and the flood of mortgage money provided by the GSEs. One of Couch's creditors was United Savings, the largest S&L in Texas. In response, United began shifting its portfolio towards mortgage-backed securities, which it considered less risky than local mortgages. By early 1988, it had "virtually stopped making home loans" and had increased its MBS holdings to more than sixty percent of its total assets.[63]

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[60] "Program Has Residents Proud of Their Neighborhood," *Houston Chronicle*, Jun. 23, 1988.
[61] Houston Proud Annual Review, 1987-1988, 4, Folder 17, Box 63, Eleanor Tinsley Papers, Houston Metropolitan Research Center.
[62] Ibid.
[63] "United adjusts to downturn," *Houston Chronicle*, Jan. 10, 1988.

Nonetheless, by the fall of 1988, United was facing record losses. In November, it agreed to enter into FSLIC oversight under the Southwest Plan.

The Southwest Plan was part of the Reagan administration's plan to "strengthen" the S&L industry.[64] Usually, the Federal Savings and Loan Insurance Corporation (FSLIC) would take control of failed thrifts, liquidate their assets, and refund depositors (up to $100,000). However, the wave of thrift failures through the 1980s had strained FSLIC's funds. Congress recapitalized FSLIC in 1986 and 1987, but the measures were insufficient. Thrifts kept failing and FSLIC did not have the money to save them without further Congressional funding. But the political will for recapitalization was dwindling. Nationwide, more than five hundred thrifts were facing insolvency by the end of 1987. In Texas, the situation was especially dire: 125 of 279 Texas thrifts were insolvent.[65] Thus, the FHLBB developed a plan that would supposedly save the government money. Unveiled in February 1988 by new FHLBB Chairman M. Danny Wall, the Southwest Plan financed a massive round of subsidized mergers that consolidated the industry. Wall was a former aide to Republican Senator Jake Garn of Utah, who co-sponsored the 1982 Garn-St. Germain depository Institutions Act. As *the Texas* Monthly reported, "in the perverse manner that often typifies life in our nation's capital, one of the architects of the problem had been anointed to try to deal with it."[66] Wall's program, which was originally called the Texas Plan, consolidated eighty-seven insolvent Texas thrifts into fifteen mega-thrifts. The Southwest Plan combined immediate and future FSLIC assistance with long-term tax breaks. Its total costs were almost certainly more than traditional FSLIC liquidation, despite the fact that the

[64] Paul M. Horvitz, "The FSLIC Crisis and the Southwest Plan," *The American Economic Review* 79:2 (May 1989), 146-150.
[65] United States General Accounting Office, *Failed Thrifts, Bank Board's 1988 Texas Resolutions: Report to the Chairman, Committee on Banking, Finance and Urban Affairs, House of Representatives* (Mar. 11, 1989), 2-3.
[66] Peter Elkind, "Rock Bottom," *Texas Monthly* 17:6 (Jun. 1989), 129.

FHBB originally promoted it as a cost-saver. When he first announced the program, Wall claimed that the Southwest Plan would cost less than $14 billion.[67] In 1989, the General Accounting Office (GAO) estimated that the Texas mergers alone would cost the government $83 billion. The thrifts created by the Southwest Plan, the report stated, were "thinly capitalized and will continue for some time to be dependent on FSLIC assistance."[68]

FHLB regulators not only provided subsidies under the Southwest Plan, they engineered the mergers and acquisitions, determining which thrifts would survive and to whom they would be sold. A "secretive San Diego banking consultant" named Ellis T. 'Bud' Gravette was the "father" of the Southwest Plan in Texas. As described by Peter Elkind, writing for the *Texas Monthly*:

> Working with a giant map of the state, Gravette placed a red-flagged pin on the site of each bankrupt institution. Then, after studying the solvent thrifts, he selected 24 to serve as hubs. Each was to take over several insolvent thrifts. the assumption was that the flagship institutions, buttressed by government aid, would stabilize and survive. Gravette marked those thrifts with blue-flagged pins. Each of the pins represented the fate of an S&L—scores of lives and millions of dollars.[69]

FHLB regulators soon determined, however, that even the supposedly healthy "hub" thrifts lacked the capital to save the insolvent thrifts. Thus, they turned to outside investors.

The investors willing and able to step into the Texas thrift debacle were some of the most prominent investment banking and corporate executives in the nation. One of these investors was Lewis Ranieri, the Salomon Brothers trader who was instrumental in the development of CMOs. With federal support, Ranieri led an investor group that purchased United Savings. Ranieri invested $400 million while FSLIC provided $2.72 billion to assume United's losses. Under Ranieri, United would rebound in the 1990s along with the Houston region as a whole. Mortgage

[67] Mason, *From Building and Loans to Bail-Outs*, 235.
[68] United States General Accounting Office, *Failed Thrifts*, 1, 4.
[69] Peter Elkind, "Rock Bottom," *Texas Monthly* 17:6 (Jun. 1989), 129.

securitization became the dominant mode of home finance. And United, like many other S&Ls that survived the crisis, increasingly became more bank-like. In 1992, it changed its name to Bank United, hoping that "the new name will show customers it provides more services than traditional savings and loans."[70] In 2001, Ranieri sold Bank United to Washington Mutual, which failed in 2008 and was placed in FDIC receivership. The FDIC then sold all of Washington Mutual's subsidiaries to JPMorgan Chase.

The story of United was typical. In 1990, Rep. Henry Gonzalez lamented, "today the financial landscape of Texas is dotted with a lot of new names—North Carolina National Bank, Chemical Bank of New York, Bank One of Ohio, Revlon Corporation—all courtesy of massive assistance and guarantees provided by the Federal Government. No one would have predicted even 5 years ago that the crisis would force Texas to give up its tradition of home-grown financial institutions."[71] During the following decades, the trend would continue. North Carolina National Bank became NationsBank, which acquired BankAmerica in 1998 to form Bank of America. In 1996, Chemical acquired Chase and took its name. Chase merged with JPMorgan in 2000 and in 2004 acquired Bank One.

Small businesses complained that the failure or acquisition of small, local financial institutions destroyed relationships that they had cultivated over many years and made it more difficult to get loans. Small businesses, "pillars of their communities" according to state treasurer Anne Richards, had "long established ties" with their local financial institution. When failing banks were merged under the Southwest Plan, "bad loans" were shunted into "collection banks," or "junk banks," overseen by the Resolution Trust Corporation (RTC), a government agency

[70] "Face lift for bank" *Houston Chronicle,* Aug. 5, 1992.
[71] *Texas Economy—Conditions and Prospects for Recovery: Hearings Before the Committee on Banking, Finance and Urban Affairs, House of Representatives*, 101st Cong. 3 (Remarks of Chairman Henry B. Gonzalez).

created in 1989 to liquidate S&L assets. Investors classified most real estate loans as "junk" and passed them on to the RTC. Many Texans, whether or not they were current on their payments, found themselves suddenly dealing with the RTC instead of their local financial institution.[72] The RTC would often try to rid themselves of these troubled assets as soon as possible, selling them at rock-bottom prices that further undermined local property values.

In addition to large, interstate bank holding companies, many smaller mortgage companies also grew during the 1980s. These companies sold all their mortgages on the secondary market. Houston's Century Corporation was one example. Its founder, Richard Campo, explained how companies like his were pioneering a new method of land development (as paraphrased by the *Chronicle*):

> In the past…land was usually speculated by a group of local investors who possessed some insider knowledge. In effect, they tried to choose land parcels based on a limited amount of research, and basically hunches. What Century is attempting to do is to quantify this approach by determining through extensive research what will be the nation's growth areas in years to come.[73]

By the end of the 1980s, whether mortgage companies or large, interstate banks originated mortgages, they most likely sold them on the secondary market to be turned into securities. In 1989, the *Chronicle* asked its readers if they "ever wonder[ed] where the money for your next house will come from now that the local savings and loan has plywood over its windows? Try Japan." Fannie Mae had just announced they would be offering $575 million in MBS specifically for foreign investors. They called it The Blackstone Fund, after the private investment banking firm that managed the transactions. Salomon Brothers and Goldman Sachs marketed the fund to potential investors, mostly Japanese. Jayne Shontell, Fannie's vice-president for mortgage-backed securities capital market transactions, admitted that the idea of

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[72] Ibid., 9 (Statement of Anne Richards, Texas State Treasurer).
[73] "Century Selling 3 Subsidiaries," *Houston Chronicle,* Dec. 24, 1986.

Japanese investors financing home mortgages might “stir anxiety in some quarters.” “It’s kind of tough because I think we're all a little schizophrenic on those things. We like the old building and loan idea from ‘It’s a Wonderful Life’[sic],” she said. But, as the fund’s promoters saw it, the foreign money would help lower mortgage rates and make attaining a mortgage easier.[74]

Conclusion

Developers sold Houston residents a “stronger sense of community and place” just as the growth of the secondary market allowed financiers to be less invested in any particular place. Houston Proud’s attempt at re-establishing local business’ role in communities through corporate charity highlighted the way in which the new system had failed to produce its own locally invested business community. “Failed” is perhaps not the best word, because the policymakers and financiers who created mortgage securitization had imagined it as freeing capital from local constraints. They had hoped for the day when pension funds in Pennsylvania would enlist Wall Street traders to purchase Fannie Mae securities based on mortgages in Los Angeles. Growth liberals like Raymond Lapin did not imagine what would happen if boom turned to bust. For them, the key was securing continued growth. When the bubble burst in Houston, subdivisions were left stranded. Many of the financial institutions that provided them with mortgages had failed. This was especially the case with smaller financial institutions. Most small institutions either failed or were acquired by larger institutions. The larger institutions that survived increasingly sold their mortgages and purchased mortgage-backed securities instead, leaving them with little vested interest in the economic life of the subdivisions they serviced. The

[74] “Yen flow into U.S. mortgages,” *Houston Chronicle*, Jun. 26, 1989.

financial landscape that emerged after Houston's bust featured more consolidated, distant, and opaque networks of power.

In Houston potential movements were thwarted by the lack of visible local villains. In Chicago, grassroots homeowner groups knew the financial institutions that were disinvesting from their neighborhoods, although they often lacked specific data to confirm this. They made arguments about a local, historical commitment that these institutions had to their communities. In Houston's new subdivisions, there were no similarly embedded and historically rooted financial institutions. It was difficult to identify the financial institutions that originated mortgages in particular Houston communities. When these institutions sold mortgages on the secondary market, the task became even more difficult. Developers were often the only visible targets for homeowner frustration. But many developers went bankrupt. And when they survived, subdivisions were often so dependent on them for municipal governance that homeowners embraced their ability to control and maintain the community's property values and aesthetic qualities. They often had little recourse, since the developer controlled the local homeowner association.

Houston's new landscape of subdivisions and homeowner associations was a somewhat extreme example of broader trends in residential development, especially in the South and West. Privately controlled homeowner associations were disproportionately prevalent in southern and western states—the same places where Fannie and Freddie bought most of their mortgages. In following decades, northeastern and midwestern cities would often try to emulate the patterns of development found in the Sun Belt. This had significant ramifications in terms of political discourse. The government's role in financing Houston's boom was largely invisible. Few Houstonians knew of the role that the secondary market played in terms of financing the residential construction boom. Nationally, commentators narrated Houston's success story as a feat of the Sun Belt's embrace of free markets and the economic downturn in the 1980s as a temporary bump caused by a downturn in the oil industry.

Between the late 1970s and the late 1980s, Houston's financial landscape changed dramatically. Houston's boom, aided by GSE securitization, encouraged rampant housing speculation by the city's financial institutions. Financial deregulation in the early 1980s furthered this trend as thrifts and banks engaged in an increasingly wide array of risky business endeavors that endangered their financial stability. Cavalier business practices, skyrocketing interest rates, and a regional oil industry downturn created a severe crisis in Houston's thrift industry during the 1980s. With scores of Texas thrifts facing insolvency, federal regulators engineered a massive consolidation of the industry under the Southwest Plan in 1987. Meanwhile, the mortgage-backed securities market boomed during the 1980s, aided by the development of CMOs and the Secondary Mortgage Market Enhancement Act (SMMEA) of 1984. By the end of the decade, the Securitized Home Finance System had displaced the New Deal Home Finance System in Houston and across the nation. Even as the securitization transformed home finance, Americans' assumptions about homeownership remained rooted in place. For the most part, Americans remained faithful to the belief that homeownership was a metonym for stability and were unaware of government policies that fueled speculation and enriched large financial institutions while transferring risk to homeowners. Few homeowners ever imagined finding themselves underwater, as millions did, seemingly overnight, in 2008.

Conclusion

When the architects of the 1968 Housing Act created mortgage securitization, they could not envision how much it would transform the American economy. In the 1960s, the mortgage market seemed the opposite of Wall Street. The home finance system depended on conservative business practices and intricate regulation. Its most important source of funding was savings accounts held by thrift institutions. For many policymakers in the 1960s, such as Raymond Lapin, these institutions seemed antiquated. These policymakers saw that the nation was entering a more volatile economic era, though they did not foresee the extent of economic turbulence that the following decades would bring. They believed that the New Deal home finance system would be unable to meet the mortgage needs of a new generation, especially in the growing regions of the Sun Belt. Yet, they could not imagine the exurban homebuilding booms that securitization would help foster in the following decades. They expected that mortgage securitization would end thrift institutions' dominance of the home finance system but they did not predict that within twenty years the thrift industry would face an existential crisis that would leave it a minor player in the mortgage market. Of course, they could not fathom that forty years after the 1968 Housing Act, mortgage securitization would spark the nation's worst economic crisis since the Great Depression. To them the idea that the mortgage system, which seemed so conservative and outdated in 1968, could create rampant speculation and ultimately panic on Wall Street would have seemed preposterous.

There is no straight line between the 1968 Housing Act and the 2008 mortgage crisis. Many intervening factors were vital in creating the conditions for the crash of 2008. The liberalization of branching regulation and regulators' encouragement of industry consolidation in the 1970s and 1980s were the first steps on the road to the creation of financial institutions that were "too big to fail." Financial institutions' abuse of the FHA Section 235 program fueled the origins of the subprime lending market. Skyrocketing inflation and interest rates in the late 1970s and early 1980s led policymakers down the path of financial deregulation. And exorbitant interest rates compounded the effects of deregulation to devastate the thrift industry. With the thrift industry in crisis during the 1980s, policymakers increasingly saw mortgage securitization as the future of home finance. Rather than complementing the thrift industry, mortgage securitization, under the auspices of Fannie Mae and Freddie Mac, became the dominant source of home finance. Meanwhile, Wall Street investment bankers worked with the GSEs to develop new financial tools like CMOs that made mortgage securities even more attractive to investors. They took advantage of the capital vacuum left by the thrift crisis and policy changes, such as the Secondary Mortgage Market Enhancement Act, that benefitted the growth of mortgage securitization.

When the American economy rebounded in the 1990s, the memory of a stable and vital thrift industry seemed distant. Mortgage securitization and the GSEs grew even faster. The Clinton Administration saw GSE securitization as a way to promote its homeownership goals, and the Bush Administration followed in the steps of its predecessor. In the 1960s, policymakers struggled to find ways of attracting new capital to the mortgage market. By the 2000s, mortgage securitization was succeeding beyond their wildest dreams. Capital streamed into the U.S.

mortgage securities market from all over the world. Mortgages became one of the hottest investment sectors. The inflow of capital, combined with corruption, lax regulation, and usurious subprime lending, created a massive housing bubble in the 2000s.

In diagnosing the causes of the crisis many contemporary commentators blamed the "irresponsibility" of homeowners in taking out mortgages beyond their financial means. Perhaps the best known articulation of this idea came from CNBC's Rick Santelli, who, in February 2009, on the floor of the Chicago Mercantile Exchange, ranted against President Obama's plan to help homeowners who faced foreclosure. With commodity traders raucously cheering him on, Santelli asked, "Do we really want to subsidize the losers' mortgages?... It's time for another tea party."[1] Lost in Santelli's narrative were the billions of dollars of subsidies that Fannie Mae had funneled into the pockets of Wall Street investors via the mortgage-backed securities market. Yet again America faced a crisis supposedly caused by the irresponsibility of the working class and their apparent disregard for their own communities and their own homes. This new narrative reflected the adaptability of the "culture of poverty" discourse. It was a mirror-image of the argument that Senator Charles Percy, President Johnson, and others made when they created mortgage securitization in 1968. GSE securitization, once held out as a panacea to fix the social problems caused by an "irresponsible" renter class, had supposedly created a new class of "irresponsible" homeowners. "Blaming the victim" proved to be an endlessly adaptable rhetorical tool.

Mortgage securitization created a new class of Americans without a financial stake in community. But they were not homeowners; they were investors in mortgage securities. While the banks that *issued* mortgages marketed them with the specifics of place in mind—by targeting low-income African and Latino communities for subprime mortgages, for example—the capital

[1] CNBC, Feb. 19, 2009, https://www.youtube.com/watch?v=zp-Jw-5Kx8k (accessed Apr. 5, 2015).

that *financed* mortgages no longer had a vested interest in specific communities and homes. Policymakers advertised the 1968 Housing Act as a solution to an "urban crisis" created by a class of poor renters who, because they did not own their homes, lacked "a stake in their community."[2] Rising homeownership rates did indeed increase residents' investment in their communities. But at the same time, on the other side of the mortgage relationship, securitization dispersed risk and diminished the responsibility of financial institutions for the economic health of specific communities.

Right-wing investment bankers, like Santelli, were not the only ones who blamed the 2008 crisis on a lack of responsibility. In August 2013, President Obama gave a speech on homeownership in Phoenix. During the 1990s and 2000s, the city had been one of the prime beneficiaries of GSE policies that directed mortgage capital from the North and East to the South and West. As in Houston, securitized mortgage capital helped to build sprawling subdivisions on the metropolitan periphery. In places like Phoenix, the 2008 crisis was especially devastating because securitization had fueled speculation and created especially significant housing bubbles.

Obama expressed nostalgia for the early postwar era when federal programs, especially the FHA, had allowed millions of Americans, including his grandfather, to become first-time homebuyers. "Buying a home required responsibility on everybody's part," he said.[3] "In that earlier generation," he continued, "houses weren't for flipping around, they weren't for speculation—houses were to live in, and to build a life with." But much had changed since the

[2] Lyndon B. Johnson, "Special Message to the Congress on Urban Problems: 'The Crisis of the Cities,'" Feb. 22, 1968, *Public Papers of the Presidents: Lyndon B. Johnson 1968-1969* (Washington, DC: Office of the Federal Register, National Archives and Records Service, General Services Administration, 1970), 253.
[3] Barack Obama, "Remarks by the President on Responsible Homeownership," Aug. 6, 2013, https://www.whitehouse.gov/the-press-office/2013/08/06/remarks-president-responsible-homeownership (accessed Apr. 13, 2015).

1950s and 1960s, he said: “over time, responsibility too often gave way to recklessness.” In the lead-up to the 2008 crisis, both lenders and homebuyers had been “reckless,” according to the President.

The discourse of “responsibility” and “recklessness”—whether it focused on bankers or homebuyers—omitted more important structural changes in the home finance system. Mortgage securitization did not necessarily have to lead to a global economic crisis, but without its creation in 1968, there would not have been a catastrophe in 2008. There probably would also not have been rising homeownership rates during a period of extreme interest rate volatility and wage stagnation. Such was the tradeoff that securitization created.

Following the federal bailout of Fannie Mae and Freddie Mac in September of 2008, some policymakers have questioned the continued need for their existence. On the right, they have become symbols for out-of-control government spending. A 2013 report by Heritage Foundation fellow David C. John proposed moving the GSEs out of federal conservatorship and into bankruptcy and then liquidating their portfolios. According to John, the GSEs are “artificial government creations” that “distort the country’s housing finance market.”[4] Some in Congress, such as Republican Representative Paul Ryan (Wisconsin) have pushed for fully privatizing the GSEs. Others have proposed a hybrid model. In June 2013, Republican Senator Bob Corker (Tennessee) and Democratic Senator Mark Warner (Virginia) unveiled a bill that would eliminate the GSEs and replace them with a “privately capitalized system” of mortgage securitization. As in 1968, when policymakers promoted GSE securitization as a way to increase the role of private capital, the Corker-Warner proposal, in reality, replaces one form of government subsidy with another. It would create a new federal agency called the Federal

[4] David C. John, “Eight Steps to Eliminate Fannie Mae and Freddie Mac—Permanently,” The Heritage Foundation, Apr. 10, 2013, http://www.heritage.org/research/reports/2013/04/eight-steps-to-eliminate-fannie-mae-and-freddie-mac-permanently (accessed Apr. 13, 2015).

Mortgage Insurance Corporation (FMIC), which would insure qualifying mortgage securities up to ninety percent of their value.[5]

President Obama has also called for the end of the GSEs special status. In his 2013 Phoenix speech, he declared that it was time to "wind down these companies that are not really government, but not really private sector… For too long, these companies were allowed to make huge profits buying mortgages, knowing that if their bets went bad, taxpayers would be left holding the bag." Instead, Obama argued, "private capital should take a bigger role in the mortgage market."[6] In May 2014, the White House came out in support of a bill similar to the Corker-Warner plan.

The future of the GSEs remains unclear. Obama declared that it was essential that "we preserve access to safe and simple mortgage products like the 30-year, fixed-rate mortgage." Widespread access to such mortgages, however, has always depended on significant federal support and regulation. Eliminating the GSEs and reducing federal subsidies for the home finance system would likely diminish access to 30-year, fixed-rate mortgages. Moreover, the GSEs still control huge mortgage portfolios. "Unwinding" or "liquidating" their portfolios would present significant challenges. In 2008, their combined portfolio size was $1.6 trillion. Under federal conservatorship, their portfolios have been reduced to about half that amount.[7] Still, the GSEs provide funding for about half of all new mortgages in the U.S. It is highly unlikely that private capital, without significant government support, could replace the GSEs role in the

[5] "Housing Finance Reform and Taxpayer Protection Act," http://www.corker.senate.gov/public/index.cfm/housing-finance-reform (accessed Apr. 16, 2015).
[6] Barack Obama, "Remarks by the President on Responsible Homeownership," Aug. 6, 2013.
[7] "The Continued Profitability of Fannie Mae and Freddie Mac Is Not Assured," Office of Inspector General, Federal Housing Finance Agency, White Paper Report, Mar. 18, 2015. http://fhfaoig.gov/Content/Files/WPR-2015-001.pdf (accessed Apr. 13, 2015).

mortgage market. A 2010 Congressional Budget Office (CBO) report on the GSEs noted that if Congress fully privatized the GSEs without replacing them with a new system of federal support, “the market would be more susceptible to fluctuations in the supply of funding.” Moreover, “during periods of acute market stress, funding could become extremely scarce without federal intervention.” A hybrid model, like the Corker-Warner plan, could also lead to mortgage shortages during periods of market stress, according to the CBO. And it could “create an incentive for excessive risk taking ” because the government would provide insurance against loss.[8]

President Obama’s 2013 speech raised an alternative to massive government support for homeownership: government assistance for rental housing. “It’s important for us to encourage homeownership, but a lot of people rent and there’s nothing wrong with renting,” he said. “In the run-up to the crisis,” he continued, “banks and governments too often made everybody feel like they had to own a home…That’s a mistake we should not repeat.”[9] The possibility of Congress passing meaningful rental assistance programs remains bleak for the time being. Nonetheless, Obama’s assertion that there was “nothing wrong with renting” stands out as a significant break with the past. Universal homeownership had been a widely shared goal of policymakers of both political parties. It was almost taken as a given that homeownership was better than renting. From Jefferson to Roosevelt to Johnson and Bush, individual property ownership seemed an essential part of the American experience. It remains to be seen if the experience of the past seven years has changed the nation’s belief that homeownership is a necessary element of the American Dream.

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[8] Congressional Budget Office, *Fannie Mae, Freddie Mac and the Federal Role in the Secondary Mortgage Market*. Washington: Congressional Budget Office (Dec. 2010), xiv-xv, http://www.cbo.gov/sites/default/files/12-23-fanniefreddie.pdf (accessed Feb. 20, 2014).
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