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Race, Risk and Real Estate: The Federal Housing Administration and Black Homeownership in the Post World War II Home Ownership State

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The existence of a property-owning majority in the United States was the result of federal institutional intervention in the period after World War II. This intervention both reduced the risks assumed by mortgage lenders and changed the terms on which mortgages were offered. By underwriting mortgages issued by lending institutions, the Federal Housing Administration (FHA) made it possible for a larger share of working and middle class individuals to own homes, but arguably exacerbated racial disparities: the property-owning majority that was created in the period after World War II was white. There is general agreement that FHA underwriting criteria played an important part in this story. Existing explanations for these criteria focus on the FHA’s incorporation of racialized criteria developed by its predecessor, the Home Owners Loan Corporation, and on the role of political bargains made to secure the cooperation of local officials and real estate interests.

In this paper, I suggest that an additional factor needs to be considered. I connect these requirements to dominant understandings about the financial risks and variations in property value associated with race. I argue that these understandings were embedded in the national financial environment, and were legitimized by the legal order. I suggest that FHA underwriting requirements were shaped by the need to secure participation by financial institutions and by the need to minimize risk to
agency funds in a legal and financial environment characterized by negative attributions about the connections among race, risk and property values. The FHA codified and reframed existing connections between race and risk, converting them into more detailed, more apparently “objective” criteria that could be operationalized in terms of measurable indicators that shaped its underwriting decisions.

“ In no country in the world is the love of property more active and more anxious than in the United States; nowhere does the majority display less inclination for those principles which threaten to alter, in whatever manner, the laws of property.” —Alexis deTocqueville, Democracy in America

INTRODUCTION: THE HOME OWNERSHIP STATE AND THE CREATION OF RACIALIZED OWNERSHIP: AN OVERVIEW

Alexis de Tocqueville’s comment sums up a traditional narrative of the historic role of home ownership in American life. America, this story indicates, was from its foundation a nation of property owners; the desire for ownership reflected a national ideology that connected home ownership to independence. The account incorporates a myth concerning historically high rates of home ownership, connecting these to individual enterprise and the individualist ethos demonstrated, for example, by Frederick Jackson Turner’s frontiersmen or Jeffersonian “yeoman farmers.” An elaborated version, such as that contained in “It’s a Wonderful Life”, emphasizes the relationship between prospective home buyers and banks or thrifts willing to lend to fru-

1 Alexis de Tocqueville, Democracy in America, 154 (Vol. 2 1838).
gal working and lower-middle class individuals. In this version, financial institutions and individual market virtues such as thrift and hard work created opportunities for ownership. The idea that disparate opportunities were provided based on race and class is absent, and state action plays no role.

This narrative has been corrected by authors such as Katznelson, Massey and Denton⁴ who demonstrate that the actual history of American home ownership tells a different story. Majority ownership, they point out, was a post-World War II phenomenon that resulted from a major innovation in the way property came to be owned: The transition was produced by the visible hand of state action rather than the invisible hand of supply and demand.⁵ This visible hand operated primarily through two programs: the Veteran’s Home Loan Program (VA program), which was laid out in Title III of Servicemen’s Readjustment Act of 1944 (Public Law 78-346) and the Federal Housing Administration (FHA) which was established by the Housing Act of 1934. Both agencies guaranteed mortgages written by institutional lenders, reducing the risks to these lenders; both these and other authors demonstrate increased ownership for Whites while imposing criteria that restricted opportunities for Black purchasers.⁶

Data support the contention that state action in the era after World War II created majority home ownership for Whites while maintaining—and exacerbating—racial disparities in ownership rates. During the period from 1900 to 1940, home ownership rates declined from 46.5 to 43.6%; the 1950 census was the

⁵ KATZNELSON, supra note 4, at 116, 138.
first to report that a majority—55%—of White Americans owned homes. The comparable figure for Blacks was 34.5%.\(^7\) This racial ownership gap was not new: double-digit disparities in ownership had been documented by each census, beginning in 1900 when racial ownership rates began to be reported.\(^8\) The tendency for Black and White rates to rise and fall in tandem, while maintaining the racial gap, was also a constant in census data. However, the gap expanded in the period after World War II: Collins and Margo (2000) find that between 1940 and 1960, ownership rates for Whites increased 24.2% as against 18.6% for Blacks, but that the racial ownership gap increased by five points during this period.\(^9\) The racial disparity in home ownership widened after the introduction of federal programs to expand access to home ownership.

While the racial ownership gap was longstanding, its persistence and growth in the era after World War II was particularly noteworthy for two reasons. First, housing values—particularly in suburban areas—increased rapidly during this period, so that racial differences in mortgage access had serious long-term effects on Blacks' ability to accumulate wealth. A number of analyses have connected this historical circumstance to the large current disparity between Black and White net worth.\(^10\)

Second, federal policy and federal institutions had become the principal source of home ownership opportunities. The state, and specifically the racialized lending practices of the Veteran's Administration and the FHA, rather than simply vague "market forces" or societal prejudice were now implicated both in the

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\(^7\) Id.


\(^9\) Id.

restriction of Black ownership and in the use of expanded ownership to produce a geographic division between White suburbs characterized by well-maintained, owner-occupied housing and densely-populated Black urban neighborhoods characterized by rental housing interspersed with dilapidated, owner-occupied properties.\footnote{See David Freund, Colored Property: State Policy and White Racial Politics in Suburban America (2010); Marc Seitles, The Perpetuation of Residential Racial Segregation in America: Historical Discrimination, Modern Forms of Exclusion, and Inclusionary Remedies, 14 J. Land Use & Envtl. L. 89 (1996); Charles Abrams, The Housing Problem and the Negro 1, 64-76 (1966); Kenneth Jackson, The Crabgrass Frontier: The Suburbanization of the United States (1985).}

Both agencies engaged in practices that produced racialized housing outcomes, although the target group for each agency differed. The VA program extended housing opportunities to veterans in order to reward their service and also to address the shortage of housing for returning soldiers and their families. However, the Black population eligible for this assistance was restricted both by the VA’s own criteria and by the fact that that the World War II military imposed recruiting quotas for Blacks.\footnote{Supra note 5, at 139-140.}

The FHA, by contrast, underwrote mortgages without imposing service requirements, drawing borrowers from a universe of working and middle-class individuals who had been disadvantaged by existing methods of home finance. The population that it ultimately advantaged was numerous and White: 98% of the private mortgages issued between 1930 and 1950 were insured by the FHA; only 2% of borrowers were non-White.\footnote{Marc Seitles, The Perpetuation of Residential Racial Segregation in America: Historical Discrimination, Modern Forms of Exclusion, and Inclusionary Remedies, 14 J. Land Use & Envtl. L. 89, 89 (1998-1999); see also, Beth J. Lief & Susan Goering, The Implementation of the Federal Mandate for Fair Housing, in Divided Neighborhoods: Changing Pattern of Racial Segregation 227, 229 (Gary A. Tobin ed., 1987).}

In this paper, I focus on the development of racialized underwriting re-
quirements by the FHA and offer a new perspective on the reasons for these requirements.\textsuperscript{14} I first explain the way in which the FHA shifted the risks assumed by mortgage lenders and restructured mortgages to make them more accessible to working and middle-class individuals. I next review the mechanisms through which FHA lending requirements produced racially discriminatory outcomes. I then discuss the role of financial and legal understandings about the relationship of race, risk and value. Finally, I conclude with a discussion of the FHA's larger role in legitimizing and reproducing racial disparities in access to ownership.

\textbf{THE FHA: SHIFTING RISKS AND RESTRUCTURING MORTGAGES}

The FHA aimed to improve access to home ownership for financially responsible borrowers who purchased properties that met its underwriting criteria. The Agency accomplished this by insuring loans made by “banks, trust companies, personal finance companies, building and loan associations, installment lending companies” and other approved financial institutions that met these criteria.\textsuperscript{15} In a 1947 memo to the President's Commission on Civil rights, Commission Secretary Robert Carr noted that “[p]erhaps the most innovative principle of the legislation [creating the FHA] was the insurance of housing loans and mortgages against default in order to encourage lending institutions to make funds available in a very adverse housing market.”\textsuperscript{16} Financial institutions could apply for loan guarantees prior to mortgage approval or within one year afterward.\textsuperscript{17}

\textsuperscript{16} Robert K. Carr, Draft Memorandum on Housing and Civil Rights (June 28, 1947) (on file with the Truman Library, RG 201, Box 20).
\textsuperscript{17} \textit{Supra} note 15, at 1247.
These guarantees shifted the risk of bad loans from private financial institutions to the public budget.

The FHA also required that these guaranteed loans incorporate terms that altered the traditional structure of newly-originated mortgages to make them more accessible to working and middle-class individuals. FHA regulations required mortgages to contain specific terms. First, up to 80% of a maximum principal of $16,000 could be financed, lowering down payment requirements. Second, the mortgage could have a duration of no more than 20 years. Third, interest rates could be no more than 6% a year. Fourth, because interest rates were to be no higher than 6%, lowering prevailing rates by at least 2%. Finally, the loan was required to be self-amortizing: That is, payments were required to reduce principal as well as to cover interest.

These terms represented a major change in the structure of newly originated home mortgages. Before the state intervened to reduce lenders' risks, mortgage terms severely restricted access to home ownership. Borrowers were required to make very high down payments – 50 to 80% of appraised value was typical – and loans were made for very short time periods; five to seven years were typical durations. Therefore, virtually all loans required refinancing. The 1931 Better Homes manual warned that “[n]o mortgage on a home should be regarded as permanent, for if there is a shortage of mortgage money when it falls due there may be difficulty about renewing it.” National bank mortgages on urban property, which became available after 1916, were made only for a one year term and required a 50% down pay-

ment. Typical mortgages did not amortize, and therefore required large balloon payments or refinancing at the conclusion of the loan period. Strict enforcement of these constraints was produced by the fact that many mortgages were designed to be resold to individual investors or to insurance trusts, both of which had a very low tolerance for risk.

Limits on financing were more stringent for Blacks. Lenders typically required higher down payments and offered shorter mortgages to these purchasers. In 1921, one lender explained to the Chicago Commission on Race Relations "that the Negroes are usually allowed $1,000 to the white man's $1,500; only 35 per cent of the value of the property is loaned to the Negro, whereas 50 per cent is granted to whites. Maximum time of loan was five years for the White and three years for the Negro." The effects of mortgage restriction on Black ownership opportunities were magnified by the fact that Blacks were typically required to pay higher prices to secure less desirable properties. Restrictive covenants and the threat of violent White response limited Black purchases to particular neighborhoods, lowering the supply of homes and raising their prices. Negative attributions about the credit-worthiness of Blacks both as earners and as consumers meant that institutions and individuals were unwilling to purchase Black mortgage notes.

These ex ante restrictions on lending grew out of the way in which financial institutions assessed risks arising both from race and from social class, dimensions that intersected one another.

22 CHI. COMM'N ON RACE RELATIONS, THE NEGRO IN CHICAGO: A STUDY OF RACE RELATIONS AND A RACE RIOT 120 (2nd ed. 1923)
23 Id. at 114.
24 Id. at 130.
25 Id. at 120.
26 Supra note 22, at 119.
Blacks were disproportionately represented in the lower and lower-middle classes. They fell into a class that, ceteris paribus, had faced difficulties in obtaining conventional financing from thrifts, banks and savings and loans. With respect to race, however, all else was not equal. As I demonstrate below, for this group, financial risks associated with class were amplified by assessments of risks associated with race.

REDUCING MORTGAGE RISK: THE MECHANISMS OF FHA DISCRIMINATION

Agency underwriting and real estate valuation practices have been widely identified as a source of racial ownership disparities. Neither the 1934 Housing Act nor FHA underwriting regulations made specific reference to Blacks or to the racial or ethnic characteristics of individual borrowers. In fact, requirements were worded to avoid references to Blacks, substituting terms such as “inharmonious racial groups.” However, the requirements that underwriting criteria established for properties and for neighborhoods had disparate racial effects both through their assessment of the value and insurability of individual properties and through their appraisal of neighborhood suitability. Housing policy expert Charles Abrams famously noted, in terms of racial implications, early editions of the Agency Underwriting Manual “read like a Chapter of Hitler’s Nuremberg Laws.”

28 This both disguised racial bias against Blacks and left open the possibility that local prejudice against particular groups, such as Jews or Mexicans, could be accommodated. Ethnic prejudice varied with localities: on the West coast, for example, covenants often targeted “Mongolians,” a racial term for Asians.
The management of risk arising from loan underwriting was central to the FHA’s mission. The 1936 Underwriting Manual laid out this agenda, noting that “[m]ortgage risk is created every time a mortgage is made. It lies in the future. The risk continues to exist throughout the life of the loan, although the degree of risk may change. It is fallacious to presume that mortgages fall into two classes viz., those that are safe and those that are unsafe. Each and every mortgage investment is hazardous to some degree. However, different mortgages vary as to degree of risk.”

The FHA’s underwriting criteria aimed to manage risk by applying actuarial principles to the mortgage underwriting process. As I demonstrate below, the indicators used to develop these assessments operationalized prevailing social constructions about the relationship of race to risk, incorporating the notion that race was a major dimension of variation in the degree of mortgage risk.

The FHA Underwriting Manual rated risk in terms of four general categories: Property, Borrower, Location and Mortgage Pattern. To rate property risk, the Manual established physical criteria for insurable homes. These criteria made detailed prescriptions about amenities such as electrical outlets (“Suitable outlets should be provided in adequate numbers in suitable locations to permit the convenient use of electrical appliances and household electrical equipment”). They established standards for acceptable kitchens (“Kitchen should have adequate windows and their placement is critical for natural ventilation”).

30 FEDERAL HOUSING ADMINISTRATION, UNDERWRITING AND VALUATION PROCEDURE UNDER TITLE II OF THE NATIONAL HOUSING ACT § 207 (1936).
32 Supra note 30, at § 221.
33 FEDERAL HOUSING ADMINISTRATION, PROPERTY STANDARDS: REQUIREMENTS FOR MORTGAGE INSURANCE UNDER TITLE II OF THE NATIONAL HOUSING ACT § 209(a), 209(c) (1936).
34 Id. at § 203.
and bathrooms ("Bathroom should be located conveniently to the bedrooms"). These standards were much more likely to be met in the newly constructed suburbs that excluded Black purchasers than in older urban neighborhoods.

Under the "Location" category, the Manual also used detailed criteria to classify neighborhoods into A, B, C and D levels based on their suitability for lending: neighborhoods rated "A" received preference, while those ranked "D" typically did not qualify for mortgages. Preference was given to neighborhoods that met specific requirements for public infrastructure that were less common in poor urban neighborhoods. The Manual noted, for example, that "publically provided sewerage systems are strongly preferred."

A weighted eight-item scale detailed the importance assigned to various factors in assessing locational suitability for mortgage insurance, although judgments about the numerical score on each indicator were subjective. These requirements were implicitly connected to racial characteristics. Forty percent of the determination was to be based on the neighborhood's "relative economic security", 20% from "protection from adverse influences," and 5% from "freedom from special hazards." Blacks were disproportionately represented among the lower-wage earners who were most insecurely employed. The movement of Blacks into an area was also viewed as a "special hazard" and an "adverse circumstance": the Manual noted, "a change in social or racial occupancy generally leads to instability and a reduction

35 Id. at § 203(d).
37 Id. at § 207(f).
38 Kenneth Jackson, Race, Ethnicity and Real Estate Appraisal: The Homeowners Loan Corporation and the Federal Housing Authority, 6 J. URB. HIST. 419, 435 (1980).
in values.”40 In order to assess the possibility of negative future change, “property evaluators were to investigate the surrounding areas for the presence of ‘incompatible racial and social groups’ and to assess whether the location might be ‘invaded’ or ‘infiltrated’ by ‘inharmonious racial groups.’”41 Residential Security maps graphically described these neighborhood distinctions, circling in red Black and racially mixed neighborhoods that were ineligible for loans.42

The indicator scores determined by evaluators were summed into a single figure that expressed the underwriting risk posed by each proposed mortgage.43 This summation process was weighted so that negative scores on particular components had greater influence. Section 228 of the Manual noted, “[i]f the sum of the individual feature ratings in any category is less than 50%, this indicates a degree of risk too great to permit issuance of the mortgage.”44 The cutoff had clear racial implications. In the Property component, as I have noted above, indicators linked to race—economic security, protection from adverse influences, and special hazards—made up 65% of the total value, raising the probability that the total score would not meet the mark in Black neighborhoods. Additionally, the lowest-rated category received the most weight in the final determination of insurability.45

Racial covenants were the Agency’s preferred method for preventing neighborhood racial change and stabilizing property values to reduce risk. The Manual noted, “… deed restrictions should be used as security against decline in desirability for residential purposes due to the encroachment of inharmonious elements.”46 Until it was revised in 1950, two years after the

40 Supra note 30, at § 233.
41 Supra note 18, at § 109.
42 Id. at § 212.
43 Id.
44 Id.
45 Id. at § 233.
46 Supra note 33, at § 201(a).
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Supreme Court in *Shelly v. Kraemer* held that state action to enforce restrictive covenants was unconstitutional, the Manual provided a model covenant to be attached to the deeds of homes in new developments.\(^{47}\) Avoiding a specific reference to Blacks, this covenant provided for “[p]rohibitions of the occupancy of properties except by the race for which they are intended.”\(^{48}\)

**INSTITUTIONAL HISTORY**

Why did these racially charged requirements become incorporated into FHA rating requirements? Given America’s troubled racial history, one broad but familiar answer seems obvious: “institutionalized racism.” The analysis that I develop attempts to unpack this explanation as it applies to the racialization of home ownership. It does so by identifying specific mechanisms that allowed racial discrimination to structure FHA efforts to expand ownership. This, in turn, offers the possibility of connecting the continued disparity between Black and White ownership to earlier practices in a new way. The connection that I suggest is that race had been constructed both by law and by financial institutions as an independent source of risk and that FHA requirements incorporated, reproduced and further legitimized this construction. In order to obtain the co-operation of lenders in the FHA program, the Agency incorporated existing understandings of the financial risks associated with race. The Agency itself also accepted these understandings, applying racial criteria in order to reduce its own risks.

FHA loan guarantees were intended to increase access to ownership specifically by reducing the risk to lending institutions. Its underwriting requirements, as I have demonstrated, provided a large advantage to White borrowers. One explanation for these racialized underwriting requirements focuses on what could be called institutional heritage, arguing that the


\(^{48}\) *Supra* note 33, at § 284(3).
FHA simply adopted and extended the discriminatory policies and practices of the Home Owners Loan Corporation (HOLC), which existed from 1933 to 1935. The HOLC was created to address the problem of mass foreclosure in the wake of the Depression. It did this by using public funds to purchase and refinance mortgages in danger of foreclosure. Like the FHA, the HOLC altered the structure of mortgages to provide borrowers with more favorable terms, lowering interest rates and extending the duration of mortgages.

The HOLC developed underwriting criteria designed to manage risk arising from these loans. These criteria anticipated those used by the FHA, producing similar racially disparate effects. The HOLC originated neighborhood rankings, although it identified preference levels with colors in addition to letters, produced “residential security maps” that excluded specific neighborhoods, and evaluated neighborhoods based on factors that included racial homogeneity, amenities, economic stability and location.

The HOLC had a major – and racially disparate – impact on the housing market. During its existence, it received applications for loan assistance that accounted for about 40% of the one to four family properties that carried mortgage debt from June 1933 to June 1935. It ultimately refinanced about 20% of all outstanding mortgages on owner-occupied properties.

49 The HOLC was established by the Home Owners' Loan Act of 1933 (Pub. L. 73-43, 48 Stat. 128) and was enacted June 13, 1933.
50 Jackson, supra note 38, at 419-52.
51 See, e.g., Amy. E. Hillier, Residential Security Maps and Neighborhood Appraisals: The Home Owners' Loan Corporation and the Case of Philadelphia, 29 Soc. Sci. Hist. 207-233 (Vol. 2 2005). It is worth noting that an alphabetic system of ratings was used- at least in Chicago- prior to the HOLC. A realtor interviewed by the Chicago Commission on Race Relations for their 1924 study of the Chicago Riot, for example, said that most Negro properties “were in the C or D class.” Supra note 22, at 158.
Overall, Blacks received only about 5% of HOLC issued mortgages.\textsuperscript{53}

A focus on the HOLC as a source of the FHA’s discriminatory requirements leaves two unanswered questions: (1) Why did the HOLC develop and employ these criteria in the first place?; and (2) Why did the FHA choose to incorporate them?

I suggest that a partial answer to this question can be found in the financial and legal environment within which the FHA operated. This environment was characterized by a connection between race and risk that created two reasons to incorporate racially disparate criteria. First, the FHA could meet its goal of expanding home ownership only if it secured the participation of financial institutions, which accepted the race/risk connection. Second, this construction of racial risk suggested that the Agency endangered its own resources by extensive lending to Blacks.

The importance of securing the participation of financial institutions was demonstrated by the fate of the first federal program to intervene in mortgage markets in order to increase ownership opportunities. The Federal Home Loan Bank was created at the initiative of Herbert Hoover by the Federal Home Loan Bank Act (Pub.L. 72–304, 47 Stat. 725), which was enacted on July 22, 1932. The Federal Home Loan Bank Act (FHLBA) was intended to provide funds to savings and loan associations to increase their liquidity, allowing them to expand mortgage lending.

Herbert Hoover laid out its mission in a 1932 letter to the editor of the Ladies Home Journal: “The broad purpose is to provide for the home owner a comparable background of stable

\textsuperscript{53} \textsc{Christopher Bonastia,} \textit{Knocking on the Door: The Federal Government’s Attempt to Desegregate the Suburbs} (2010). This figure, of course, was two percentage points higher than the share of mortgages granted to Blacks under the FHA.
credit with that we have already provided nationally for the business man through the Federal Reserve Banks and for the farmer through the Farm Loan Banks and the Intermediate Credit Banks. The plan and method is not to engage the new institutions in the business of providing direct loans but to give impulse, security and safety and lower interest rates to the already existing institutions, especially the mutual institutions in order that they may extend the fullest measure of credit to would-be home owners.  

The institution was eventually given authority to make direct loans.

The FHLBA's mission was not accomplished. The Act had virtually no effect on the expansion of ownership because member banks did not alter their accustomed lending criteria, and because very few savings and loans applied for funds. In the first two years of operation, 41,000 applications were received and 4 loans were approved. This failure demonstrated the importance of securing the co-operation of private financial institutions in state attempts to expand ownership. The failure of this first attempt to construct state intervention into the markets for home finance suggested that obtaining this co-operation would require close attention to the way in which these institutions assessed risk and constructed lending requirements.

54 Letter from Herbert Hoover (May 13, 1932) (on file with Hoover Library).
56 Jackson, supra note 11.
57 Gordon, for example, points out that the development of federal programs to insure lending required both the negotiation of many agreements with financial institutions and the reworking of existing regulations. Adam Gordon, The Creation of Homeownership: How New Deal Changes in Banking Regulations Simultaneously Made Homeownership More Accessible to Whites and Out of Reach for Blacks 115 Yale L. J. 186 (2005).
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EXPANDED OWNERSHIP AND THE MANAGEMENT OF POLITICAL RISK

The FHLB was intended to provide concrete support for a national agenda around the expansion of ownership that begun in the period around World War I. This initial effort to extend ownership, which has received less attention than that, which occurred after World War II, was initiated by concerns that limited access to ownership might create a majority of citizens who had little attachment to the institution of private property and by the belief that home ownership created a citizenry with a bricks and mortar interest in social, economic and political stability. It was, in brief, intended to manage political risks created by specific historical circumstances.

Concerns about stability and potential threats to capitalism resulted from international and domestic challenges: the Bolshevik revolution in Russia and fear that the movement was spreading in the United States; the growth of radical unionism; waves of urban riots in 1919, and particularly the Chicago Riot; and, the persistence of business cycles. Concerns about the spread of Bolshevism and radical unionism led to a desire to increase the share of citizens who had a concrete interest in the institution of private property. Workers of both races, Blacks in particular, were identified as targets for Communist organizing.

59 See generally, GEORGE WHITEFIELD MEAD, THE GREAT MENACE (1920).
60 CAMERON McWHIRTER, RED SUMMER (Henry Holt ed. 2011).
61 Supra note 22.
62 See, e.g., PRESIDENT'S CONF. ON HOME BUILDING AND HOME OWNERSHIP, REP. OF THE COMM'S ON HOME OWNERSHIP, INCOME AND TYPES OF DWELLINGS 14-17 (James M. Gries & James Ford, eds. 1932).
Congressional hearings and political and popular discourse reiterated the theme that Blacks and union members were fodder for Bolshevik organizers.63 “Reds Try to Stir Negroes to Revolt,” read one 1919 New York Times headline; “Radical Propaganda among Negroes Growing,” and “Negroes of the World Prey of Agitators; Campaign, Backed by Bolsheviks and IWW Is Opened for Self-Determination,” warned others.64 The persistence of business cycles provided an impetus to extend ownership in order to ramp up and stabilize the construction and related home goods industries. The intensive investigation of the bloody Chicago Riot of 1919, which included extensive social scientific analysis, found that areas with high rates of ownership experienced less violence.65

Reflecting these concerns, political discourse connected expanded ownership with the national interest. The Republican Party Platform of 1920 summed up this interest: “A nation of home owners is the best guaranty of the maintenance of those principles of liberty, law and order upon which our government is founded.”66 In 1922, Calvin Coolidge opined, “It is of little avail to assert that there is an inherent right to own property unless there is an open opportunity that this right may be enjoyed to a fair degree by all. That which is referred to in such critical terms as capitalism cannot prevail unless it is adapted to the general requirements. Unless it is of the people, it will cease to have a place under our institutions, even as slavery ceased.”67

In the same year Herbert Hoover echoed these concerns: “The

64 See, Reds Try to Stir Negroes to Revolt, N.Y. TIMES, July 28,1919, at 1; Radical Propaganda among Negroes Growing, N.Y. TIMES, October 5., 1919, at 1; Negroes of World Prey of Agitators, N.Y. TIMES, August 24, 1919, at 1.
65 Supra note 22.
average individual is influenced by his way of life, by his environment and it does not seem at all unlikely that if the proportion of non-home owners becomes so great that legislation is enacted at the behest of a majority of voters, it will be inimical to private property rights. . .a nation of majority government should be a nation of majority home owners.”

From the perspective of national policy, these concerns had two implications. First, they implied that the most appropriate targets for extended ownership would be two groups who were excluded by the practices of private financial institutions: Blacks, who were disadvantaged by race and were disproportionately represented among lower-waged workers; and working and lower middle-class Whites. Paradoxically, they also implied that this extension had to be accomplished in a way that would preserve the private character of ownership, that is, by incentivizing private finance rather than providing direct government funding for property purchasers. In the long term, this strategy was expected to reduce state intervention in housing markets: “We have ample evidence,” Herbert Hoover wrote in 1931, “that too great reliance on rented dwellings tends in the modern industrial state to inadequate housing and the demand for state participation in housing.”

Early attempts to develop a national role in housing finance to facilitate expanded ownership included consideration of barriers to Black ownership. The 1931 Conference on Home Building and Home Ownership called by President Herbert Hoover, for instance, reported on the work of 31 committees that had spent a year examining the existing state of home ownership. One of these committees, the Committee on Negro Housing, received the second-highest level of funding and produced a 273
page report that identified difficulties with property finance as the major barrier to Black home ownership.\textsuperscript{70}

The FHLB itself was presented as one way to address this difficulty. The Atlanta Daily World, a newspaper aimed at a Black audience, laid out this argument: "The creation of the federal home loan bank board and the throwing of the wheels of the home Loan bank under federal auspices will prove a tremendous boon to the many thousands of Negro home and property owners because its underlying objective is to help the smaller man in his dire needs and desires to liquidate his resources into cash. The injection of this provision which allows on loans on valuations in excess of twenty thousand dollars is the final stimulus which will bring the advantages of this new board within the reach of the Negro people since the main body of the Race has just about an average of that sum to realize upon while the mass of Negroes in the country represent the nation's smaller group as indicted in the definition of the Home Loan Bank Act, which was passed by Congress and signed by President Hoover on July 22."\textsuperscript{71} Both Black and White authorities suggested that Blacks should be included on the Board of this institution, although this never occurred.\textsuperscript{72}

The discussion above suggests that attempts to expand the home ownership state were partially triggered and structured by the idea that expanded ownership would create a citizenry with a concrete interest in the institution of private property and would also create conditions for increased social, economic and political stability. The financing practices of lending institutions were uniformly identified as a major barrier to expanded owner-

\textsuperscript{70} Charles S. Johnson, Negro Housing: Report of the Comm. on Negro Housing (John M. Cries & James Ford, eds.1932). However, the recommendations of the Negro Housing Committee that suggested action to overcome barriers to Black ownership were not adopted in the final report of the Conference on Home Building and Home Ownership.

\textsuperscript{71} T.W. Anderson, Federal Loan Bank Board to Aid Home Owners, Pittsburgh Courier, August 23, 1932, at 3.

\textsuperscript{72} Jackson, supra note 11, at 90.
ship, but direct national intervention in home finance smacked of the socialism that it was intended to prevent. As the failure of the FHLB demonstrated, national policies could incentivize but could not compel lender participation. Therefore, federal lending programs could succeed only if they operated within the paradigm accepted by lending institutions, a paradigm that included existing constructions of racialized risk.

**RACE AND RISK IN FINANCE AND LAW**

Neither the HOLC nor the FHA originated the idea that the financial risks arising from race were more severe than those arising from class alone. Both agencies operated within a financial and legal environment that had institutionalized two notions. First, although the financial risks arising from race typically included those arising from class, racial risks were construed to be much more complex and potentially much more serious. Second, these risks could be summed up by the idea that Black residence lowered property values.\(^3\) \(^7\) HOLC and later FHA lending criteria attempted to quantify these racial risks both in order to secure the co-operation of financial institutions and in order to conserve Agency resources. This was particularly necessary because Agency requirements regarding the restructuring of mortgages—that is, extended duration and lower interest rates and down payment requirements—increased the risks arising from class.

Class played a part in the assessments of racial risk. Black workers were, as a group, likely to have lower and less secure incomes than Whites. Describing racial barriers to home ownership, the 1921 report of the Chicago Civil Rights Commission, which conducted an extensive interviews of bank officials and

\(^3\) Light, however, suggests that as FHA criteria evolved, more complicated constructions of locational risk developed, so that a more complex scheme that took ethnicity into account came to be used to determine locational risk in urban areas. Jennifer S. Light, *Nationality and Neighborhood Risk at the Origins of FHA Underwriting*, 36 *J. of Urban Hist.* 634-371 (2010).
realtors as part of its study of the Chicago Riot of 1919, noted that "The Negro population of America, due to factors in its history, constitutes at present a considerable proportion of the familiar low-income group families and, in like manner, has in its own composition a larger proportion of families of this level than is true of other groups of the population."  

Black employment was believed to be less secure than that of Whites: a survey of Chicago lenders found that most shared the belief that "if wage reductions become general they will fall most heavily on unskilled workers and render difficult the meeting of payments by such Negroes, who constitute the great majority." Race and class interacted to create a circumstance in which, the Chicago Riot Commission Report noted "how the Negro is to be financed in his effort to improve his citizenship and home life through home ownership . . . becomes a matter of great concern."  

However, race posed specific additional risks. In its final report to the 1931 National Conference on Home Building and Home Ownership, the Committee on Negro Housing listed eleven factors that distinguished difficulties with improving Black ownership and housing opportunities from those involved with expanding opportunities for Whites:

"1. The course of selection and segregation that, almost without exception, draws the Negro population into the most deteriorated residence sections of the city. This is in part the process of city growth, in part economic selection and segregation, and in part racial selection, the tendency to compactness and group solidarity. This is enforced in part from without and in part from within.

74 CHI. COMM’N ON RACE RELATIONS, supra note 22, at 221.
75 Id. at 223.
76 Id. at 83.
2. The accelerated rate of deterioration inherent in the character of Negro properties, due to age and use.

3. The depreciation of property values attributed to Negro occupancy or proximity. This is in part economic and in part psychological.

4. Segregation legislation designed to restrict areas of residence as a public measure.

5. Restrictive compacts and covenants, designed to restrict areas of Negro residence as a private measure.

6. Objection of White residents to the presence of Negroes in certain areas, as registered in: (a) Clashes, (b) Bombings of property, and (c) Intimidation.

7. Exclusion of the Negroes from new housing developments.

8. Limitation of facilities for financing of Negro home ownership.

9. Increased rentals with Negro occupancy.

10. Factors related to the level of culture of the majority population of the Negro group, as reflected in the care of property.

11. The relation of such physical factors as excessive congestion, and physical deterioration to correspondingly excessive rates of delinquency and mortality in Negro areas.  

These characteristics can be partially understood as a catalogue of racial risks arising both from individual behavior and from neighborhood characteristics. These risks fall into three categories. First, both the residences of individual Blacks and Black neighborhoods were poorly maintained and prone to ac-

77 Supra note 62.
celerated deterioration, making them unsuitable for investment. Second, high rates of Black residence were associated with elevated rates of violence, crime, delinquency, and other social problems that affected investment values. Third, in an environment characterized by geographic restrictions on Black occupancy, conditions were almost certain to deteriorate, further reducing property values and affecting longer-term returns.

The notion that Black residence produced declining property values did not originate with the HOLC or with the FHA. HOLC and FHA housing assessment grids reflected existing understandings of real estate investment and appraisal practices.\(^\text{78}\) HOLC and FHA evaluation criteria were partially developed by Frederick Babcock, author of a classic 1932 text, *The Valuation of Real Estate*. Chapter VII of this text was devoted to a discussion of “Influence of Social and Racial Factors on Value.” He noted that while small degrees of neighborhood heterogeneity did not produce rapid declines in value, “[t]here is one difference in people, namely race, which results in a very rapid decline.”\(^\text{79}\)

Other contemporary studies of land values and valuation practices took a similar view of the connection between race and property value. In his 1933 study *One Hundred Years of Land Values in Chicago*, Homer Hoyt notes that “land values in areas occupied by certain racial and national groups are invariably low because of the lower rents that these groups pay, their greater deteriorating effects on property, and white people’s unwillingness to live near them.” He then cites a rating system developed by a Chicago real estate broker that presents a numeric scale connecting neighborhood ethnicity and property values: neighborhoods in which English residents predominated ranked high-


\(^\text{79}\) Frederick M. Babcock, *The Valuation of Real Estate in the United States* 9 (1932).
est of the 10 categories. Those in which Blacks settled were ranked 9th, followed only by those that had Mexican residents.80

Negative attributions about the condition of properties occupied by Blacks were also common among lenders and realtors. For example, a realtor told the Chicago Commission on Race Relations, “For the most part the physical surroundings of the Negro family, as indicated by these family histories, are poor. . . The ordinary conveniences, considered necessities by the average white citizen, are often lacking. Bathrooms are often missing. Gas lighting is common, and electric lighting is a rarity. Heating is commonly done by wood or coal stoves, and furnaces are rather exceptional.”81 These difficulties were also connected to financial mismanagement by Black owners. Another lender, for example, told the Chicago Commission, “[m]any Negroes purchased fairly substantial dwellings on the long-time installment [sic] plan without providing for repairs and maintenance.”82

The FHA’s requirement that evaluators examine surrounding neighborhoods to determine the possibility of “invasion” or “infiltration” by other racial groups echoed the recommendations of standard appraisal authorities of the day. McMichael’s 1931 text, for example, described the process of deterioration that transformed neighborhoods into “twilight” or “blighted” zones, noting as a primary cause “invasion by incompatible uses” such as “social or racial changes.”83

Understandings about the relationship of race and property value were also embedded in the legal order, further legitimizing the connection between Black residence and lowered prop-

80 Homer Hoyt, One Hundred Years of Land Values in Chicago 13 (1933).
81 Supra note 22, at 152.
82 Id. at 200.
property values. From around 1920, extensive litigation around restrictive covenants both reflected and legitimized the connection. The majority of decisions upholding covenants typically held that they served a legitimate public purpose – that of maintaining the value of covered properties. On the other hand, successful challenges to covenants most often relied on the doctrine of “changed circumstances,” which held that if the purpose of a covenant had been frustrated by changes in external circumstances, it could be voided. The legal theory presented by these cases was that the influx of Blacks into areas surrounding the restricted properties had already reduced their value, frustrating their purpose. In the 1944 case of *Fairchild v. Raines*, for example, the California Supreme Court relied on testimony of local residents, including a physician and a real estate agent, to find that the purpose of the covenant had been frustrated because “the damage occasioned that neighborhood by negro occupancy had already been sustained by reason of the influx of Negroes... in the same tract.”

The connection between race and reduced values was also incorporated into official understandings of property law. In 1944, the American Law Institute issued a revised edition of its *Restatement of Property*. These periodic Restatements were in-

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85 See e.g., CLEMENT E. VOSE, CAUCASIANS ONLY: THE SUPREME COURT, THE NAACP AND THE RESTRICTIVE COVENANT CASES (1959) and Clement E. Vose, NAACP Strategy in the Covenant Cases, 6 CASE W. RES. L. REV. 101 (1955). Hundreds of court cases that challenged to restrictive covenants were conducted by the NAACP and a few private attorneys before the decision in *Shelley v. Kraemer*.
88 Supra note 18, at 47.
89 Fairchild v. Raines, 24 Cal. 2d 818, 823 (Cal. 1944).
tended to communicate current understandings about best practices in property law. As part of the ALI’s continuing attempt to harmonize apparently contradictory rules of common and case law, this restatement attempted to provide an authoritative resolution to an apparent contradiction: both in terms of common law and in settled case law, a critical element of ownership was the right of owners to dispose of – or alienate – property as they saw fit. Exceptions were warranted only if they met compelling state interests. The revised Restatement held that despite their substantial impact on the issue of alienation, restrictive covenants were warranted by the compelling need to stabilize property values and to alleviate social tensions.⁹⁰

**CONCLUSION: THE FHA AND RACIAL RISK**

As this discussion has demonstrated, the FHA was created in a financial and legal environment that was pervaded by a racialized notion of risk. The FHA did not originate the notion that race exacerbated lending risks, but it legitimized and reproduced these understandings at a critical period in the history of American home ownership. The Agency’s role in promoting racial ownership disparities in the period after World War II was well-known at the time, drawing criticism from Black organizations such as the NAACP and the Urban League,⁹¹ from Black newspapers such as the Chicago Defender,⁹² and from Civil Rights advocates within the federal government, including the Committee on Civil Rights created by President Truman.⁹³

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⁹⁰ American Law Institute, Restatement of the Law of Property (1944).
⁹¹ President’s Comm. on Civil Rights, Draft of Report on Housing 56 (Harry S Truman Library, RG 220, 1941-1947)
⁹³ Supra note 91. See also, Louis Hyman, Debtor Nation: The History of America in Red Ink (2011).
FHA responses to these challenges, however, demonstrated the Agency’s deep attachment to racialized lending practices. As I have noted above, while state action to enforce restrictive covenants was enjoined by *Shelley v. Kraemer* in 1947, the FHA recommended the use of covenants until 1950, continuing a practice that aimed specifically to stabilize investment values and reduce lender risk.

The Agency’s attempts to manage criticism also included an institutional change designed to take account of regional differences in understandings about the connections among race, risk and property. In 1946, the Agency established a race relations service to provide assistance in addressing minority issues, but this development occurred in the context of a transition to “decentralized management” that employed regional race relations specialists to “harmonize” FHA policies with local racial housing practices, allowing local constructions of racial risk to shape the implementation of federal ownership policies. In sum, the FHA’s efforts in the post-World War II period re-shaped and reinforced existing connections among race, property and risk.

94 Memorandum from Frank Horne, Special Assistant to the Housing and Home Finance Agency Administrator (HHFA), on Minority Group Considerations in the Administration of Governmental Housing Programs to the HHFA Staff (June 20, 1947) (on file with the Harry S. Truman Library).