History of The 30 Year Mortgage — From Historic Rates To Present Time

Mortgages have helped millions of people all over the world buy homes. Even if you don't have $300,000 cash, you can buy a $300,000 home using a mortgage.

Where did mortgages come from? What makes mortgages different from other loans? Should you apply for a mortgage? Today, we're telling you everything you've ever wanted to know about the history of mortgages.

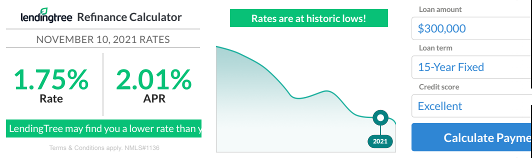
Early history of the mortgage

The modern mortgage has only been around since the 1930s, but the *idea* of a mortgage has been around for a lot longer.

First, it's important to talk about the meaning of the word 'mortgage'. To understand the word, we need to break it down into two separate Latin words: 'mort' and 'gage'. 'Mort' means 'death' and 'gage' means 'pledge'. A mortgage is a dead pledge.

Don't let that scare you! The dead part of the mortgage doesn't refer to you or any other person. Instead, it refers to the idea that the pledge died once the loan was repaid, and also the idea that the property was 'dead' (or forfeit) if the loan wasn't repaid.

Mortgages are mentioned in English common law documents that take back as far as 1190. These documents illustrate the beginnings of a basic mortgage system. They describe how a creditor is protected in property purchase agreements. Specifically, a mortgage was a conditional sale where the creditor held the title to the property while the debtor could sell that property in order to recover the money paid.



Essentially, a mortgage is a loan secured by a property. Most people don't have the liquid capital required to purchase a house entirely on its own and mortgages help these people purchase homes and properties.

The first mortgages in America

The idea of a mortgage started in England and moved throughout the western world from 1190 onward. In the late 1800s and early 1900s, America's waves of immigrants increased the need for mortgages and affordable property.

Unfortunately, mortgages at the turn of the century were different from mortgages today. In the early 1900s, homebuyers typically had to pay a 50% down payment with a 5 year amortization period. This meant that those who bought a house or property typically already had a lot of money. If you were buying a $100,000 house, you would have to pay $50,000 *and* pay off the remaining $50,000 within 5 years.

Increasing the likelihood of default was the fact that mortgages were structured completely differently than modern mortgages. On a 5 year mortgage, homebuyers would pay interest-only payments for the 5 year term. At the end of the 5 years, they would face a balloon payment with the entire principal of the loan.

This system wasn't perfect, but it did provide homes and properties to millions of Americans. However, once the Great Depression hit, mortgages would never be the same again. During the Great Depression, lenders had no money to lend — of course, borrowers didn't have any money to pay for the hard-to-find loans either.

The Great Depression and the New Deal

Roosevelt's New Deal may have made America what it is today. The New Deal included a number of important regulations that made America a more consumer-friendly nation. The New Deal was designed to stimulate consumer spending and promote economic growth. At the same time, the banking and financial industries would face more scrutiny and regulation.

The Federal Housing Administration (FHA) was created in 1934 and was built to protect lenders and reduce lending risk. Since lenders had become extremely cautious about lending since the Great Depression, this was severely hindering economic growth. The FHA solved this by protecting lenders and substantially reducing the risk of a borrower defaulting on a loan.

To do that, the FHA created a number of valuable mortgage services. They created the 30-year mortgage, for example, and reduced the down payment required on new home sales. The FHA also created an appraisal system that helped lenders assess the risk in a certain property. The 8-part appraisal system included indicators like "protection from adverse influences" and "relative economic stability."

Loans that met the FHA's standards of approval were known as FHA-insured loans. There were also a number of neighborhoods built across the country known as FHA-insured neighborhoods which facilitated the mortgage process for new homebuyers and encouraged lending activity.

Ultimately, the FHA created the modern American mortgage by adding the following systems:

- **Quality standards**: In order to qualify for an FHA-insured loan, a home had to meet certain quality standards. These standards measured the home's likeliness to hold its value over time. Homes which were more likely to hold their value were more likely to receive an FHA-insured loan.
- **Lowered down payment requirements:** The FHA started a program that offered 80% to 90% loan-to-value (LTV). Private lenders had to offer similar rates in order to compete. This successfully lowered down payment requirements.
- **15 year to 30 year loans:** A typical mortgage before 1930 only had a 3 to 5 year period. The FHA began offering 15 year to 30 year loans, stretching out payments and making it more affordable for medium-income individuals to buy a home.
- **Amortization periods:** Prior to the FHA, mortgages did not have an amortization period. Instead, mortgages involved paying a series of interest-only payments with one large balloon payment at the end of the term which was the entire principal of the loan. This made defaults a common occurrence and discouraged lending, which is why the FHA created the idea of amortization. Amortization involves paying off both interest and principal amounts with each payment.

The FHA continues to exist to this day and play a critical role in the U.S. mortgage market. It regulates mortgage loan insurance, promotes an efficient home financing system, and improves housing standards and conditions across the country.

1938 and the creation of Fannie Mae

Fannie Mae is the nickname for the Federal National Mortgage Association (FNMA). The FNMA was created in 1938 in order to increase the amount of money available to borrowers using mortgage securitization.

To do that, Fannie Mae purchased FHA-insured loans and then sold those loans as securities on financial markets. This created the secondary mortgage market and gave lenders a new source of capital. Since loans were packaged and sold together, they theoretically carried less risk. Even if a homebuyer defaulted on their loan, it was unlikely that multiple borrowers in a package would also default.

That's not all Fannie Mae did; the organization also mandated fair and efficient lending practices. If lenders didn't meet Fannie Mae's guidelines, then their loans would not be packaged as securities and sold on financial markets. Guidelines included interest rates, underwriting practices, and other loan terms and suggested lending practices.

As we all know, mortgage securitization played a critical role in the 2008 recession. However, in the 1930s, Fannie Mae was praised for creating capital in a capital-starved country.

Baby Boomers and the end of World War II

The post-war 1940s and 1950s were a booming time for America. Soldiers returning from the war were ready to settle down, buy homes, start families, and become good American consumers.

To help veterans returning home from the war, the Veterans Administration created a mortgage insurance system of its own. Just like the FHA, the Veterans Administration protected lenders against borrower default and insured mortgage loans made by private lenders to veterans.

This allowed veterans to purchase homes at affordable rates without a down payment. This was an extremely popular system that created a surge in demand on the housing and mortgage markets. The economy boomed and America's mortgage system was praised for being efficient and stable.

1970s and the creation of Freddie Mac

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As Baby Boomers grew older, their housing demands increased. They wanted to purchase larger and more expensive homes. Unfortunately, the mortgage market didn't quite have enough capital available to finance the needs of these homebuyers.

That's where Freddie Mac comes in. In 1970, the U.S. Congress created an organization called the Federal Home Loan Mortgage Corporation (FHLMC). Today, we know that organization as Freddie Mac. The organization was designed to increase the amount of financial capital available to mortgage lenders and, by extension, borrowers.

To do that, Freddie Mac operated in a similar way to Fannie Mae. The organization purchased mortgages from lenders, giving them more capital to spend on more mortgages. Freddie Mac is also well-known for offering 30 year fixed-rate mortgages, giving buyers the opportunity to lock in a mortgage at a lower interest rate in order to hedge their bets against rising interest rates in the future.

At the same time, interest rates were rapidly rising. Interest rates rose sharply throughout the 1970s and 1980s and eventually rose above 20%. In previous years, lenders were happy to provide mortgages with 20 to 30 year periods, but during this period of exceptionally high interest rates, most mortgages included 1 year, 3 year, or 5 year terms. It wasn't until the late 1990s that interest rates finally fell below 7%.

In 1972, Fannie Mae and Freddie Mac both began to purchase conventional mortgages that were not guaranteed or insured by the FHA or VA. Instead of seeking approval from the FHA or VA, loans could be insured by Private Mortgage Insurance (PMI) companies.

1980s and adjustable rate mortgages

Adjustable rate mortgages (ARMs) were a product of the 1980s. Prior to the 1980s, buyers were restricted to fixed-rate mortgages which featured a fix rate throughout the term of the loan.

Adjustable rate mortgages were the opposite: interest rates reset over the course of the mortgage. Homebuyers may have signed their mortgage when interest rates were at 20% and then reaped the benefits of their ARM when interest rates dropped to 5% a decade later.

Unfortunately, ARMs also created an opportunity for predatory lenders. ARMs often featured attractive introductory interest rates designed to entice homebuyers into signing up for a mortgage. Then, once that initial low-interest rate period was over, homebuyers were faced with more difficult interest rates and often defaulted on their loans.

The Federal Housing Enterprises Financial Safety and Soundness Act of 1992

FHEFSSA is a mouthful. It stands for the Federal Housing Enterprises Financial Safety and Soundness Act, which was passed in 1992 and designed to increase government oversight of the mortgage industry.

The FHEFSSA created the Office of Federal Housing Enterprise Oversight (OFHEO). That Office held some authority over Fannie Mae and Freddie Mac and also established minimum capital standards for both companies.

Unfortunately, those capital standards were criticized for being too low. In fact, Fannie Mae and Freddie Mac had approximately one fifth of the capital requirements of other financial institutions, which means they would be unable to cover their losses as well as other institutions during times of crisis. As government-funded companies, this meant taxpayers would have to bail out both companies in a time of crisis — which is exactly what happened during the Great Recession.

1990s and the effort to increase home ownership rates

The high interest rates of the 1990s discouraged people from buying homes. Who could afford to pay for a mortgage with a 20% interest rate?

The U.S. government decided to increase American home ownership to 70%. One of the best ways to do that was to reduce mortgage requirements and encourage subprime lending. During this period, subprime mortgages increased from $35 billion to $125 billion and millions of people who were not really qualified to buy homes became homeowners.

At the same time, Wall Street and lenders in the financial industry created attractive mortgage products designed to attract new homebuyers. Those products included "80/20" loans. Typically, mortgages with a Loan-to-Value above 80 would be required to pay mortgage insurance. To avoid this costly insurance, homebuyers could create two mortgages: an 80% first mortgage and a 20% second mortgage.

However, one of the worst and most predatory mortgage products created during this period was the option ARM loan. An option ARM loan was an adjustable rate loan which contained multiple repayment options. These loans often featured repayment options where buyers owed more at the end of each month than they did at the beginning. Low monthly payments sounded attractive but borrowers were eventually stuck with extremely large mortgages they could not afford.

Ultimately, these factors achieved the government's goal of increased home ownership across the country. Unfortunately, that increased home ownership would come at a high price.

The Great Recession

The years leading up to the "Great Recession" of 2008 and 2009 were a great time for mortgage companies. Unfortunately, the good times didn't last long.

The Great Recession was caused by a number of different factors, including a U.S. housing bubble which peaked in July 2006, subprime lending, and a lack of liquidity.

The U.S. housing bubble had generally remained stable throughout modern U.S. history before reaching an astronomical high in July 2006. By late 2006 and 2007, housing prices had declined and in 2008, the bubble finally burst as home price indexes across the country reported record-breaking price drops. This was seen as being the primary cause of the Great Recession.

At the same time, subprime mortgage lenders — fuelled by a lack of regulation — happily gave out mortgages to virtually anyone who asked. These lenders were accused of using predatory techniques to lure unqualified homebuyers into purchasing a mortgage for a home that they could never hope to afford.

Many homebuyers defaulted on their subprime mortgages. At the same time, the housing bubble had burst, which meant that homebuyers were paying for mortgages that were worth far more than the actual value of the home, encouraging them to default.

All of these factors combined to create the phenomenon we know as the Great Recession. The combination of predatory lending, subprime mortgages, and the housing bubble created the worst economic recession of our time.

Fannie Mae and Freddie Mac under government receivership

In September of 2008, both Fannie Mae and Freddie Mac were placed under government receivership. The government was then responsible for all outstanding mortgages that had been purchased or guaranteed by both companies — a total of $6 trillion dollars' worth of mortgages ($12 trillion dollars in outstanding mortgages existed in the United States at the time).

The government takeover of Fannie Mae and Freddie Mac cost American taxpayers billions of dollars. The bailout is estimated to have cost around $200 billion and only a fraction of that loan has been repaid.

The bailout of Freddie Mac and Fannie Mae forced many people to rethink the modern American mortgage. America simply cannot afford to have another Great Recession.

Today, mortgages are more difficult to obtain than they were before the Great Recession. In order to prevent another mortgage catastrophe, buyers need to be educated about their mortgages and terms. At the same time, the US must reduce predatory lending and regulate the mortgage industry to prevent irresponsible behavior by private financial companies.

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About Johnson Hur

After having graduated with a degree in Finance and working for a Fortune 500 company for several years, Johnson decided to follow his passion by embarking on a path to the digital world. He has over 8 years of experience with large companies setting marketing strategy.

2 comments

Ed George July 23, 2016 at 7:22 am

I thought what I would apply for was a loan. And that a mortgage was what I would give to the lender if it loaned me the money.

Reply

Hanebury John October 13, 2016 at 10:57 am

It is my understanding that the federal government had a considerable amount of responsibility in the mortgage industry collapse. The Government was twisting the arms of lending institutions to make subprime loans to those who were very unlikely to pay those loans back. In one such case Citicorp was sued because they were not making enough loans to minorities. Obama himself was involved as a lawyer in the litigation. Citicorp lost. I also watched Barney Frank standing before Congress. A Republican Congressman, challenging him, said that we were at serious risk of a financial disaster due to so many subprime loans (encouraged by the government through threats of bank audits) being issued. Barney Frank responded by saying that in order to have more homeownership “it is worth the risk”. I blame the Federal Government and the Democrats for the world wide crash in 2008 as they were the main driving force —— everyone should own a home —— typical socialism! Bankers are not stupid. They would have never caused such a risky environment on their own.

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