Timeline: Mortgages from 1190 to Today

Mortgages from 1190 to 1934

The idea of mortgages started in England and moved throughout the West in 1190. The term “mortgage” is derived from a Law French term used in Britain in the Middle Ages meaning “death pledge”—referring to the pledge ending (dying) when either the obligation is fulfilled, or the property is taken via foreclosure.

The rush of immigration into America in the late 1800s/early 1900s prompted a growing need for affordable property. Unsurprisingly, an increasing number of private lenders started issuing mortgages to supply the demand. These mortgages typically required a 50% down payment on a 5-year term where the homebuyer would make interest-only payments for the entire 5 years, followed by a balloon payment at the end to cover the principal borrowed. These terms remained the same up until the Great Depression.

When the Great Depression hit, however, borrowers were unable to afford mortgages under those terms and lenders were left without liquidity to lend. President Franklin D. Roosevelt responded to the economic catastrophe by:

1. Establishing the Home Owners’ Loan Corporation (HOLC) to purchase defaulted mortgages from banks and refinance them with a fixed-rate and longer term.
2. Establishing the Federal Housing Administration (FHA) to provide mortgage insurance.
3. Establishing the Federal National Mortgage Association (FNMA or Fannie Mae) to create a secondary market for mortgages (thus providing liquidity for lenders to be able to offer more mortgages).
4. Establishing the Federal Deposit Insurance Corporation to insure bank deposits.
5. Passing the Glass-Steagall Act to prohibit banks from investing depositors' funds in risky ventures like the stock market.

These measures (collectively under the New Deal) ushered in the era of mortgages we know today.

I’ll go through 1-3 in more detail below.

Mortgages from 1934 to Today

1. Home Owners’ Loan Corporation (HOLC)

In 1933, with nearly 25% of homes already in foreclosure, the HOLC was established to refinance the 20-25% of the nation’s outstanding mortgage debt in default to prevent additional foreclosures. The HOLC purchased nearly a million mortgages by using capital raised from issuing bonds.

HOLC refinanced mortgages with a ~5% interest rate, when most mortgages at the time were from 6 to 8%, and a 15-year amortized term, when commercial banks (e.g., BAML, JPMC) offered 3 to 6-year terms and thrift banks (S&L lenders) offered 10 to 12-year terms.

2. Federal Housing Administration (FHA)

The FHA was created in 1934 to encourage more lending by removing barriers for prospective borrowers and reducing risk for lenders. It did so by:

- Mitigating default/foreclosure risk for lenders: The FHA insured loans that met certain quality standards (mostly measured by the home's likeliness to hold its value).
- Lowering down payment requirements: The FHA started program to offer 80-90% LTV (loan-to-value) mortgages. To compete, private lenders had to follow suit.
- Offering 15 to 30-year term loans: From 3 to 5-year terms before.
- Establishing amortization periods: Amortization involves interest and principal payments on each given repayment period. Before, borrowers would make interest-only payments for the term of the loan, followed by a balloon payment at the end (the principal amount).

Footnotes:

- In 1944, The Department of Veterans Affairs started a mortgage insurance system of their own to further encourage lending to WWII veterans returning home. In addition to providing default protection to lenders, the VA also lowered down payment requirements for borrowers.
- In 1957, Max Karl founded the Mortgage Guarantee Insurance Corporation, the first Private Mortgage Insurance (PMI) company, by raising $250k from friends and other investors after being frustrated by the amount of time and money needed to obtain a home backed by federal insurance.

3. Federal National Mortgage Association (FNMA or Fannie Mae)

Fannie Mae was created in 1938 to provide liquidity to lenders to facilitate more lending by purchasing individual FHA-insured loans (that also met their guidelines) off lenders' books.

As WWII veterans returned home and Baby Boomers grew older, the total number/value of mortgages catapulted to unanticipated heights in the 40s and 50s, the federal government began a series of steps to (1) remove the outstanding mortgage debt (and risk) from the federal budget, (2) increase liquidity, and (3) further stimulate originations:

1. In 1950, the Housing and Home Finance Agency acquired Fannie Mae from the Federal Loan Agency.
2. In 1954, the Federal National Mortgage Association Charter made Fannie Mae into a mixed-ownership corporation (the federal government would hold preferred stock while private investors could purchase common stock).
3. In 1968, the government split Fannie Mae into Fannie Mae and Ginnie Mae (Government National Mortgage Association). Then, converted Fannie Mae into the privately held cooperation we know today.
4. That same year (1968), Fannie Mae created a secondary market for mortgages by securitizing and selling its positions to the private markets. As of 2018, the size of the Mortgage-Backed Securities (MBS) is roughly $9 trillion.

Footnotes:

- In 1970, to prevent Fannie Mae from becoming a private monopoly, the government created the Federal Home Loan Mortgage Corporation (FHLMC or Freddie Mac).
- The government subsequently granted Fannie Mae and Freddie Mac authorization to purchase conventional loans (loans not insured by the FHA, VA, or FmHA (Farmers Home Administration)).
- The main difference between Fannie Mae and Freddie Mac today is that Fannie Mae purchases mortgages from commercial lenders whereas Freddie Mac purchases from thrift lenders.