

PANEL DISCUSSION ON *SAVING THE NEIGHBORHOOD*: PART III

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I. THE STRUCTURE OF MORTGAGES	40
II. THE IMPACT OF INTEGRATION ON HOUSING VALUES IN NEW YORK CITY.....	41
III. ASSESSMENTS OF THE QUALITY OF BLACK NEIGHBORHOODS BY REAL ESTATE PROFESSIONALS IN THE 1930S	43
IV. FINAL COMMENTS	46

My comments are both complimentary and complementary. Let's start with the complimentary. *Saving the Neighborhood*¹ is a great book. It is a must-read for anybody who studies segregation, particularly in housing. Richard Brooks and Carol Rose have effectively put themselves into the minds of the discriminators, the discriminated-against, the legal profession, and the segregation busters, and have thought through the various ways in which they all reacted to segregation. In the process, the authors document the legal means as well as the informal methods that discriminators used to promote segregation, and how those means and methods changed over time. I was surprised at how difficult it was to set up a foolproof legal form of segregation through covenants, and was disturbed and fascinated by how the discriminators supplemented the covenants with a wide variety of informal arrangements that made the covenants look more forbidding from the outside than they actually were. Those informal arrangements turn out to have been powerful means of maintaining segregation, even as the legality of segregation was challenged and then overthrown. Brooks and Rose do an excellent job of describing the groups that sought to break down segregation. Reformers and housing entrepreneurs often developed uneasy alliances based on quite different motives in working to open up opportunities for mixed-race neighborhoods.

There is little to criticize in the book, so I now shift to the complementary parts of my comments. Three strands of new research on housing in the 1920s and 1930s offer opportunities to add to and build upon the analysis performed in *Saving the Neighborhood*. First, one of the informal means of enforcing

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1. RICHARD R. W. BROOKS & CAROL M. ROSE, *SAVING THE NEIGHBORHOOD: RACIALLY RESTRICTIVE COVENANTS, LAW, AND SOCIAL NORMS* (2013).

segregation likely came through the loan process in the mortgage markets in the 1920s and 1930s. Second, recent research by Trevor Kollmann for New York City in the 1920s and 1930s measures the impact on housing values of changes in the racial mix in a neighborhood. Third, Shawn Kantor, Trevor Kollmann, and I have collected and digitized information on nearly 10,000 neighborhoods in cities throughout the United States in the 1930s from surveys performed by the Home Owners' Loan Corporation ("HOLC"). The surveys collected information on housing values, the quality of housing, the characteristics of people, and the "security" grades assigned to neighborhoods by mortgage brokers, real estate agents, and other real estate professionals. The survey was designed to determine how neighborhood characteristics influenced the value of the housing and the likelihood that the value of housing would fall in the future in the neighborhood. I perform some preliminary analysis of the data here to offer new insights into the mindsets of the real estate professionals about the effect of race on housing markets during a period when segregation was not illegal.

I. THE STRUCTURE OF MORTGAGES

During the 1920s and 1930s the forms of mortgage contracts likely gave lenders greater incentives to enforce racial covenants informally than does the modern mortgage. A common mortgage contract was an interest-only mortgage for five years (or less) in which the borrower repaid the principal on the loan at the end of the mortgage. For a \$2,000 loan at 6% interest over 5 years, the monthly payment on the loan was \$10 per month for the 5 years and then the borrower repaid \$2,000 at the end. About 30–40% of most nonfarm mortgage loans came from individuals who sold the house to the borrower. As Brooks and Rose document, a large share of the population believed that a shift toward a mixed-race neighborhood from an all-white neighborhood would lead to declines in property values. The individual lender who was part of a segregated neighborhood was likely to try to maintain any racial covenants because he had not fully left the neighborhood with the sale of the home. The success of his loan was still strongly tied to neighborhood housing values until the end of the loan when the principal was due. Many times, borrowers were not able to repay fully the principal at the end of the loan. In most cases, they paid some of the principal and then rolled the remainder into a new loan. If the original seller provided the rollover loan, then his stake in the neighborhood continued through the next loan period as well. This further reinforced his desire to enforce racial covenants that kept housing prices high by both lender and borrower.

The commercial lenders who were most active in mortgage markets were Building and Loan Associations ("B&Ls"). A number of B&Ls were started by builders and real estate brokers to help them in sales of houses in their developments. The B&Ls were also like mutual societies in which people of similar backgrounds joined together to help each other finance their homes. The mutual nature of the B&Ls meant that problems that led to falling housing values for some members of the B&L could lead to foreclosures and trouble for the B&L that would spill over to the rest of the B&L members. Thus, any factor that damaged housing values was a threat to all B&L investors. This gave the

leadership and members of the B&Ls more incentive to enforce racial segregation in the neighborhoods where the lending was taking place.

The spillover effect was strengthened by the nature of the standard B&L mortgage, the Share Accumulation Contract (“SAC”). It combined an interest-only loan like the ones above—but with an uncertain ending date—with a contract to purchase shares in the Building and Loan. The shares bought by the borrower were put into a “sinking fund.” Each month, the borrower’s newly purchased shares were added to the sinking fund, and several times a year dividend payments on the shares were added to the fund. Once the value of the shares in the sinking fund was equal to the principal amount borrowed—and not before—the borrower could pay off the loan and get title to her home. Any problems that led to reductions in the dividends or reductions in the value of the shares in the sinking fund meant that it would take longer for the borrower to repay the loan. Thus, if housing values began sinking as a neighborhood integrated, the probabilities of foreclosure went up, and increased foreclosures would have led to everybody in the B&L having to make more payments before they could finish the mortgage. This economic incentive gave even nondiscriminatory B&L members a reason to support racial covenants and other means of maintaining segregated neighborhoods when it was thought that integration harmed housing values. Modern mortgages, known as direct reduction contracts, do not have these uncertain features. Each payment is used partly to pay interest and partly to pay down the principal on the loan. Thus, the principal owed declines continuously over time.²

II. THE IMPACT OF INTEGRATION ON HOUSING VALUES IN NEW YORK CITY

Although whites have often worried about the impact of other races and ethnic groups moving into their neighborhoods, the impact on housing prices and rents is relatively complex. In his dissertation at the University of Arizona, Trevor Kollmann analyzed the impact on housing prices of changes in the racial mix in New York City neighborhoods.³ In theory, the movement of blacks into a neighborhood could have multiple effects. In segregated cities where blacks had long been located in specific enclaves, movement of black families into a neighborhood could lead to higher housing prices in the early stages. The limited supply of housing for blacks in those cases meant that they were paying higher prices than whites for the same quality of housing. As a result, when the first few blacks moved into a neighborhood, there could be an increase in the price of housing because of a rise in demand from black buyers who were paying higher prices elsewhere. As the share of blacks in the neighborhood increased, however, it could reach a tipping point that generated white flight from the neighborhood. The consequent decline in white demand for housing in the neighborhood could then lead to a decline in housing values.

2. For further discussion of the mortgage markets along with the Home Owners’ Loan Corporation, see PRICE FISHBACK, JONATHAN ROSE & KENNETH SNOWDEN, *WELL WORTH SAVING: HOW THE NEW DEAL SAFEGUARDED HOME OWNERSHIP* (2013).

3. Trevor Kollmann, *Housing Markets, Government Programs, and Race During the Great Depression* (2011) (unpublished Ph.D. dissertation, University of Arizona) (on file with author).

After 1900, there was a substantial rise in the black population in each of the five boroughs of New York City. The black population had always been concentrated in particular areas, but the rise in population increasingly led black families to push to move into new locations, often near the old locations. Figures 1A & 1B show the share black in the New York City Census tracts in 1920 and 1940. The maps show how the New York City population filled in the land area between 1920 and 1940, as more and more places were included in the Census tract boundaries. Darker areas on the map had a higher share of the black population and the maps show how the share black rose in various parts of the city with close-ups of the patterns in the Harlem and Bedford-Stuyvesant districts that were traditional black enclaves. The changes show a common pattern in which the black households increased their share in locations near the areas where other blacks were living.

Kollmann combined information on housing values from the HOLC surveys with this type of Census tract information to measure the effects of this migration of black households across neighborhoods. Kollmann could easily show the correlations between housing values and the black population share. It is much more difficult to determine the extent to which an influx of the black population *caused* the change in housing prices because the direction of causation could move both ways. Black households might have chosen to move to low price neighborhoods just as easily as their presence might have contributed to a drop in prices. To try to measure the extent to which black inflows into a neighborhood *caused* changes in prices, Kollmann used an econometric technique known as instrumental variables. He sought a variable that would be strongly correlated with the changes in black shares of the population in the neighborhood but not correlated with housing prices in that neighborhood after controlling for other neighborhood characteristics. The variable he chose is based on two common features of migration patterns: migrants tend to move to locations where they know other people and drops in income in their place of origin often push people to become migrants. Kollmann identified the birth places of the blacks in the neighborhoods from the Census data in 1930 to identify from where likely in-migrants would come. He then developed a weighted average measure of changes in per capita income in those birthplaces during the early 1930s that might have pushed people from those places to migrate to New York City. For example, if half the people in the New York City neighborhood were born in Alabama and the other half in Mississippi, Kollmann gave half of the weight to per capita income changes in Alabama and half in Mississippi. Since the per capita incomes in these locations were extremely unlikely to be correlated with housing values in a neighborhood in New York City, except through their influence on the black migration out of the state and eventually into the New York City neighborhood, this serves as a good instrument. Essentially, the instrumental variable estimation takes the component of black migration into a neighborhood that was associated with the changes in the push out of the states of origin of those migrants and shows how that component influenced housing values.

Kollmann's results show the pattern developed by the complex theory. When the share of the black population in the neighborhood was relatively small, more black in-migration led to increases in housing values. However, there was a

tipping point around the 30–40% black share. Above that level an increase in the black share of the population led to a drop in housing values and the drop was larger as the percent black increased.

III. ASSESSMENTS OF THE QUALITY OF BLACK NEIGHBORHOODS BY REAL ESTATE PROFESSIONALS IN THE 1930S

Over the last decade, Shawn Kantor, Trevor Kollmann, and I have been collecting and digitizing survey information collected by the HOLC on thousands of neighborhoods in the 1930s. The information is particularly useful for gaining insight into how real estate professionals viewed the impact of racial segregation on the prospects for making loans to homeowners in the neighborhood. The HOLC was a government corporation created in 1933. Between 1933 and 1936, it issued bonds and used the bonds to purchase over 1 million nonfarm mortgages that were in danger of foreclosure from lenders throughout the United States. This accounted for roughly 20% of all nonfarm mortgages at the time. The HOLC then turned around and refinanced the mortgages for the borrowers at lower interest rates with direct reduction loans that extended the length of the loan. A recent assessment of the HOLC shows that it replaced the toxic assets on mortgage lenders' books at little loss to the lenders, helped keep 800,000 people in their homes, and helped stave off any further declines in home ownership rates and housing values in the latter half of the 1930s. As the program was starting, the size of the subsidy provided to housing markets was probably around 20% of the value of the loans made because people anticipated a great deal of risk in refinancing the troubled loans. After the HOLC closed down in 1951, the final accounting showed losses of about 2% of the value of the loans.⁴

After refinancing the loans, the HOLC embarked on a set of surveys of neighborhoods in most large cities between 1935 and 1939. It sought to understand the housing and mortgage markets in each city. For each neighborhood, it contacted real estate professionals who were actively involved in the area to get their assessment of the “security” of the neighborhood for making loans. It compiled information on the age and quality of housing, various neighborhood characteristics, and the types of people living in the neighborhood, and then asked the professionals to give a security grade from a high of “A” to a low of “D.” Lower grades meant that making loans in those neighborhoods was riskier because borrowers in those neighborhoods were more likely to default on the loans. When making maps of the neighborhoods, the HOLC used a color scheme, and the D neighborhoods were colored in red.⁵ Some people claim that this is the source of the term “red-lining,” but it is not clear that this is true. Although some have charged that the HOLC actively discriminated against blacks and the neighborhoods that were later colored in red, Amy Hillier’s study of Philadelphia finds that the HOLC was making loans to blacks and in these neighborhoods.⁶

4. See FISHBACK ET AL., *supra* note 2.

5. The records were located in over 150 boxes in the Federal Home Loan Bank Records. Record Group 195, Home Owners’ Loan Corporation, Records Relating to the City Survey File, 1935–1940, National Archives II, College Park, Maryland.

6. See Amy E. Hillier, *Who Received Loans? Home Owners’ Loan Corporation Lending and Discrimination in Philadelphia in the 1930s*, J. PLAN. HIST., Feb.

Recent research on the impact of government programs on black and white home ownership shows no statistically significant relationship between HOLC lending and the home ownership rates for blacks and whites. The same study also finds a positive relationship between Federal Housing Administration (“FHA”) insurance of home loans and home ownership for both blacks and whites. On the other hand, it is highly likely that the FHA had access to the HOLC information and made use of it in trying to keep risks of foreclosure low in making loans.

The distribution of security grades across the black shares of the population in Table 1 shows that the vast majority of neighborhoods with large black populations were given the lowest security grade. Consistent with the tipping story shown by Kollmann’s analysis of housing values in New York City, the security grades were substantially higher in neighborhoods with smaller shares of black populations. But are the low security grades just a sign that the real estate professionals saw a neighborhood’s racial mix as the primary determinant of the quality of the neighborhood? The unfortunate legacy of slavery meant that many blacks had lower incomes and lived in lower quality neighborhoods than whites. It may have been that it was the low incomes and the lower quality housing that was driving the choices about security grade.

The relative importance of the different factors determining the security grade can be assessed using a multivariate regression. The dependent variable ($Grade_{ijt}$) assigns numeric values of 4 for grade A, 3 for B, 2 for C, and 1 for D for neighborhood i in city j in year t . The coefficients in equation (1) are estimated using an Ordinary Least Squares (“OLS”) regression.

$$\begin{aligned}
 Grade_{ijt} = & a_0 + a_1 pb(0-10)_{ij} + a_2 pb(10-30)_{ij} + a_3 pb(30-40)_{ij} + a_4 pb(40-50)_{ij} + \\
 & a_5 pb(50-80)_{ij} + a_6 pb(above 80)_{ij} + a_7 Income_{ij} + a_8 percent\ foreign-born_{ij} + \\
 & a_9 Home\ Age_{ij} + a_{10} Percent\ Homes\ in\ Good\ Condition_{ij} + \\
 & a_{11} Percent\ Homes\ in\ Fair\ Condition_{ij} + a_{12} Percent\ Homes\ in\ Poor\ Condition_{ij} + \\
 & a_{13} Share\ Owning\ Home_{ij} + a_{14} Home\ Value_{ij} + a_{15} percent\ brick_{ij} + \\
 & a_{14} percent\ Frame_{ij} + City_j + Year_t + \varepsilon_{ijt}. \tag{1}
 \end{aligned}$$

The $pb()$ variables show the black population share in the neighborhoods and the a coefficients for the $pb()$ variables show how much higher or lower the grade is in a neighborhood in that percent black range than the grade was in a completely nonblack neighborhood. The remaining variables and coefficients are included to control for the other features of the population in the neighborhood, like average income and percent foreign-born, and the housing characteristics in the neighborhood, like average age of homes, the percentage of homes in different conditions, average home value, and the type of construction. A vector of city dummy variables ($City_j$) is included to control for features of each city that were common to all neighborhoods in the city. A second vector ($Year_t$) is a series of dummy variables that control for features of different years that were common to

2003, at 3–24; see also Trevor Kollmann & Price Fishback, *The New Deal, Race, and Home Ownership in the 1920s and 1930s*, 101 AM. ECON. REV. (PAPERS & PROC.) 366–70 (2011).

all of the neighborhoods surveyed in that year. The error term ε_{ijt} captures unmeasured features of the neighborhoods.

Table 2 shows the a coefficients for the percent black measures. In specification 1, when none of the other correlates in equation 1 are included, the coefficients show that the security grade is substantially lower in neighborhoods with higher shares of black population. Compared to a neighborhood with no blacks, a neighborhood with a black share greater than 0 and less than 10% had a security grade that was -0.73 points lower. In a neighborhood with more than 80% black, the security grade was more than -1.55 points lower, and the negative effects for the neighborhoods in between are between -0.73 and -1.55. Because no other factors are included in the analysis, these results are similar to the figures in Table 1.

In specification 2, when we add all of the other correlates from Equation 1 to the analysis, the negative effects of the percent black are much smaller. A neighborhood with a percent black share between 0 and 10 received a grade that was -0.2 points lower than the neighborhood with no blacks. The neighborhoods with more than 80% black populations received a security grade that was -0.51 points lower than the nonblack neighborhood. Why is there a difference between specifications 1 and 2? As we speculated, many blacks were living in neighborhoods with lower quality housing and lower housing values, the types of neighborhoods that would have received low grades even if there were no blacks in the neighborhood.

To give a sense of how important the racial mix was relative to the other features of the neighborhoods in determining the security grade, Table 3 shows the effect of a change in the other factors included in equation 1 and specification 2 on the security grades. A common change within the sample was a change of one standard deviation (“OSD”). Houses that were in poor or fair condition had about the same sized negative effects as having a large share of blacks in the neighborhood. A neighborhood where the percent of homes in fair or poor condition were OSD higher had a grade that was half a point lower. The other features of the neighborhood had smaller effects. Neighborhoods with average incomes or average home values that were OSD higher had security grades that were about 0.1 points higher. The OSD effects for neighborhoods with older homes or frame construction were around -0.1. Finally, ethnic mix also had an effect on the security grades, as neighborhoods with an OSD higher percent foreign-born had security grades that were -0.15 points lower.

In the final analysis, the results show that both the condition of housing and the racial and ethnic mix influenced the real estate professionals’ opinions of the risk of lending in the neighborhoods. It is clear that blacks were located primarily in lower grade neighborhoods where the real estate professionals thought the risk of foreclosures on loans was higher. Much of the reason for the low grades had to do with other conditions of the neighborhood. Yet, even after those conditions are taken into account, the professionals gave grades that were up to a half-point lower purely based on the percent black in the neighborhood. They apparently saw the racial mix as one of several signals that lending risks were higher in the neighborhoods.

IV. FINAL COMMENTS

Richard Brooks and Carol Rose have written a superb book about the formal and informal ways in which housing segregation developed in the United States. My goal has been to supplement their story with recent research on the 1920s and 1930s that has come to light since they finished the manuscript. The nature of mortgage contracts and lending institutions at the time was likely another mechanism through which segregation patterns were enforced. The recent research highlights the complexity of the relationship between housing values and the inflow of blacks into a neighborhood. In New York City in the 1930s, prices rose when the inflows occurred in neighborhoods with low black population shares, but dropped when the inflows occurred in neighborhoods with black population shares of more than 40%. Finally, the security grades that real estate professionals gave neighborhoods depended a great deal on characteristics unrelated to race, but they also assigned grades up to half a point lower to areas with large black populations. We cannot know for sure, but we can speculate that some portion of these opinions likely came from an unwillingness to work with blacks, while other portions may have been formed by past experiences unmeasured by the variables in the regression.

Table 1

Distribution of Security Grades by Percent Black in Neighborhood

Security Grade	All	100% Black	50% to 99% Black	1% to 49% Black
A	11.1	0	0	0.1
B	27.8	0	0	4.1
C	40.8	7.5	5.9	34.2
D	20.4	92.5	93.7	61.6

Table 2
Regression Coefficients for Ranges of Percent Black in Neighborhoods

Percent Black	1	2
0<p<=10	-0.73*	-0.20*
10<p<=30	-1.18*	-0.38*
30<p<=40	-1.28*	-0.43*
40<p<=50	- 1.24*	-0.33*
50<p<=80	-1.48*	-0.46*
over 80	-1.55*	-0.51*
Other Correlates Included	No	Yes
City and Year Dummies	No	Yes
N	6489	4085

Source: Results from regression of numerical grade using the HOLC neighborhood data. The asterisk (*) shows that the coefficient is significantly different from zero in a two-tailed *t*-test at the 90 percent level.

Table 3
Effects on Numerical Security Grade of a One-Standard Deviation Change in Variable

Variable	Effect on Grade
Average Income (hundreds)	0.096
% Foreign-Born	-0.151
Age midpoint	-0.112
Condition-Good	-0.175
Condition-Fair	-0.475
Condition-Poor	-0.493
Home Ownership rate	0.164
Value of 1-Single Family Home (thousands)	0.099
Percent Brick	0.005
Percent Frame	-0.099
City-Fixed Effects	Yes
Year-Fixed Effects	Yes

Source: These are calculated from the coefficients in the regressions with specification 2 for which results were shown in Table 2.

Figure 1A: Map of New York City Showing the Percent Black in Census Tracts in 1920



Figure 1B: Map of New York City Showing the Percent Black in Census Tracts in 1940

