**Executive Summary**

This memo describes the primary *types* of financial institutions that originated residential mortgages in the United States from the late nineteenth-century through the early twenty-first. "Mortgage origination" involves funding a mortgage loan for a homeowner. This process often involves more actors than just a lender and a borrower. In recent decades, for example, mortgage brokers served as matchmakers between lenders and borrowers. In addition, the entity that funds a loan draws on capital from elsewhere, as with a non-bank mortgage lender that draws on a warehouse line of credit from a bank. Changes in the broader mortgage finance system have periodically arisen from economic shocks, government regulations, interest rate fluctuations and the introduction of new technologies.

## I. Glossary of Lending Origination Entities

*Banks:* Banks, the most well-known type of financial institution, take in deposits and use them as a source of funds to originate loans. Compared to other types of depository institutions, banks often have a wider scope (e.g. credit cards, wealth management, investment banking) and often lend in a wider variety of sectors (construction, business loans, and consumer credit, as well as residential real estate).

*Buildings and Loans Associations:* Buildings and Loans Associations (B&Ls) were predecessor institutions to Savings and Loans (S&Ls). Typically mutually owned thrift (i.e. savings) organizations, they focused nearly exclusively on residential real estate. B&L members (the mutually owned feature) paid into the institution and received interest on their deposits (the thrift or savings feature). Management would then deploy pooled funds to write mortgages for members.[1]

*Savings and Loans and Thrifts:* Savings and Loans (S&Ls) and thrifts are depository institutions that share some features with banks, but tend to be much smaller and narrower in scope. S&Ls and thrifts began as community savings and lending vehicles in which local participants would pool funds to allow members to purchase homes. As mortgage payments replenished capital, an S&L or thrift would lend to other members. The modern form of S&Ls and thrifts are depository institutions that maintain a strong focus on residential mortgage lending.[2]

*Credit Unions:* Like banks, credit unions take in deposits and make loans. Unlike banks, credit unions are non-profits and open to members only, though in recent years membership definitions have become less restrictive.[3]

*Mortgage Brokers:* As intermediaries between lenders and borrowers, mortgage brokers work to connect borrowers with lenders, and deal with the administrative aspects of a loan transaction (e.g. paperwork), earning a commission from closing each deal. Consumer-oriented mortgage brokers find the best rates for borrowers. While they do not directly fund loans,[4] brokers are an important player in many mortgage originations and have become more significant in recent decades.

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[1] See, for example, "The Prolonged Resolution of Troubled Real Estate Lenders During the 1930s," Rose, Jonathan D., May 8, 2012, Federal Reserve Board.

[2] See, for example, "Savings and Loan Crisis," *Federal Reserve History*, available at https://www.federalreservehistory.org/essays/savings-and-loan-crisis#what.

[3] See, for example, "What is a credit union?" *CNBC,* available at https://www.cnbc.com/select/what-is-a-credit-union/.

[4] Some brokers do however "table-fund" loans (this is also known as correspondent lending). These brokers are listed as the lender on loan documents, though the actual funding of the loan comes from a third-party source, often

*Mortgage Bankers:* Mortgage banking companies typically raise short-term capital to fund mortgage loans, generally through borrowing in the capital markets or arranging a warehouse line of credit from a commercial bank. Since mortgage banks do not take in deposits to fund loans, so they must sell their loans in the secondary market. Mortgage bankers come in a variety of forms and some resemble mortgage brokers.

*Nonbank Lenders:* Including finance companies, these lenders generally finance loans not through deposits, but instead through vehicles including warehouse lines of credit from banks and sometimes more complex financing vehicles. Typically, these entities hold mortgages themselves for a very limited time, prior to either securitizing the mortgages or selling them for securitization. Like mortgage brokerage, non-bank lenders have become a more significant part of the origination story over the past thirty years.[5]

## II. Buildings and Loans Associations before the Great Depression

Buildings and loans associations (B&Ls) were an important mortgage originator in the decades leading up to the Great Depression. These associations are portrayed in *It's a Wonderful Life* a la the Bailey Brothers Bank. B&L's were an early form of generating financing for home loans. Members of a local community would pay into a common pool and would take turns using the aggregate proceeds to fund a home purchase or construction. As borrowers paid off loans, returning principal and interest back into the common pool, B&Ls made additional home loans.[6]

As noted, B&Ls were major mortgage originators at the time.[7] By the late 1920s these associations owned 48% of institutionally held mortgage debt outstanding on single family homes.[8] There were upwards of 12,000 B&Ls by the late 1920s with over 12 million members of B&Ls, representing roughly one third of total U.S. families.[9]

B&Ls played such a prominent role in mortgage origination in part because of minimal government involvement in the mortgage finance system. No government insurance protected against mortgage loan defaults, and so originators mostly held loans rather than selling them in a secondary market. Many B&Ls also were able to offer fully amortizing long-term mortgages, in contrast to the more typical, short-term, balloon payment, low loan-to-value mortgages that other lenders offered during this era.[10] In addition, the

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a warehouse line of credit from a bank. *See*, "Mortgage Brokers, Correspondent Lenders, and Table Funding," *NCLC Digital Library*, available at https://library.nclc.org/ml/010402-0.

5 "Calculated Risk: Mortgage Origination Channels for UberNerds." Accessed January 22, 2021. https://www.calculatedriskblog.com/2007/09/mortgage-origination-channels-for.html.

6 "It's a Wonderful Loan: A Short History of Building and Loan Associations," Price, David A. and John R. Walter, Federal Reserve Bank of Richmond, Economic Brief, January 2019, available at https://www.richmondfed.org/-/media/richmondfedorg/publications/research/economic_brief/2019/pdf/eb_19-01.pdf.

7 See, for example, "Forbearance by Contract: How Building and Loans Mitigated the Mortgage Crisis of the 1930s," Fleitas, Sebastian, Price Fishback, and Kenneth Snowden, August 25, 2015.

8 Fishback, Price, Sebastian Fleitas, Jonathan Rose, and Ken Snowden. 2020. "Collateral Damage: The Impact of Foreclosures on New Home Mortgage Lending in the 1930s." *The Journal of Economic History*

9 "Forbearance by Contract: How Building and Loans Mitigated the Mortgage Crisis of the 1930s," Fleitas, Sebastian, Price Fishback, and Kenneth Snowden, August 25, 2015.

10 "Forbearance by Contract: How Building and Loans Mitigated the Mortgage Crisis of the 1930s," Fleitas, Sebastian, Price Fishback, and Kenneth Snowden, August 25, 2015; "The Federal Home Loan Bank (FHLB) System and Selected Policy Issues," Congressional Research Services, August 27, 2020.

lack of alternative sources of capital limited competition, as did B&Ls stature as local, community-driven organizations that knew borrowers well.

The shock of the Great Depression, however, caused many extant B&L lenders to fold, weakening the sector.[11] Subsequent government interventions to stabilize the credit markets led to the rise of new actors that originated mortgage loans.[12]

**III. The rise of S&Ls**

The response to the Great Depression was vast and it transformed the U.S. mortgage finance system. The intervention and changes to the mortgage finance system soon gave rise to Savings & Loans (S&Ls) as an important origination vehicle. Some of the responses to the Great Depression that encouraged new entrants into mortgage origination included:[13]

- the Federal Home Loans Bank Act: Enacted in 1932, this act established twelve regional Federal Home Loan Banks (FHLBs), which received the power to charter and oversee Savings & Loans. This system of FHLBs addressed liquidity shortfalls faced by S&Ls and other nonbank depositories during the Depression by providing cash advances to mortgage lenders. The FHLBs also supported low and moderate-income lending through loan subsidies and grants.[14]

- the Home Owners Loan Act: This legislation established the Home Owners Loan Corporation (HOLC) between 1933 and 1934, which refinanced the mortgages of distressed homeowners. The new mortgages were of longer-term (typically 15 to 20 years) and at lower and fixed interest rates. HOLC's actions helped to create the modern, long-term, fixed rate mortgage.[15]

- the Federal Housing Administration: Created by Congress in 1934, the FHA insured lenders against losses on certain qualifying mortgages, set the foundations of the secondary mortgage market, and fostered the development of long-term fixed rate mortgages.

- Fannie Mae: Congress authorized the Federal National Mortgage Association in 1938 to help banks finance the newly created long-term, fixed rate mortgage loan.[16] Prior to the creation of Fannie Mae, banks struggled to identify sufficient funds to continue making home loans, especially amid the Depression. The role of Fannie Mae was to purchase mortgages on the secondary market from banks, providing them with liquidity.[17]

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[11] "Forbearance by Contract: How Building and Loans Mitigated the Mortgage Crisis of the 1930s," Fleitas, Sebastian, Price Fishback, and Kenneth Snowden, August 25, 2015.
[12] Emmons, William R. "The Past, Present and Future of the U.S. Mortgage Market," n.d., 3.
[13] This section is adapted from "Housing Finance in the United States: The Transformation of the U.S. Housing Finance System," Joint Center for Housing Studies, Harvard University, July 2002, pp. 3 – 9.
[14] "The Federal Home Loan Bank (FHLB) System and Selected Policy Issues," Congressional Research Services, August 27, 2020.
[15] "Statement by the President on the Record of the Home Owners' Loan Corporation," Harry Truman Library and Museum, available at https://www.trumanlibrary.gov/library/public-papers/51/statement-president-record-home-owners-loan-corporation.
[16] "History," *Fannie Mae*, www.fanniemae.com/about-us/who-we-are/history
[17] "Introduction to Mortgages & Mortgage-Backed Securities," Green, Richard, 2014, p. 4.

These interventions greatly reduced the advantages of B&Ls, and made S&Ls a much more important vehicle for mortgage origination activity.[18] The FHLB both created a path for entrepreneurs to charter S&Ls, and then offered them access to a Federal Reserve-style discount facility (i.e. lending window); with the rise of the FHA, S&Ls were able to insure new mortgages against losses. The discount facility and insurance scheme for new mortgages allowed this new class of S&Ls to lend and succeed. Amid the widespread failures of B&Ls, these new federally chartered S&Ls had a distinct competitive advantage in that they had access to mortgage insurance, the discount window through FHLBs, and other benefits.[19]

S&Ls eventually dominated the origination market. By 1950 S&Ls and similar thrift institutions accounted for 36 percent of all residential mortgage debt outstanding. The presence of S&Ls grew through the 1970s, accounting for 65 percent of all residential mortgage debt outstanding by that decade.[20]

### IV. The S&L crisis and the decline of S&Ls

S&Ls encountered significant problems in the 1980s, with many failing as part of what observers called the S&L crisis (which has some features similar to a bank run). S&Ls loaned money long-term for mortgages, and borrowed short-term through deposits. In the aftermath of the 1970s oil shocks, rapid increases in inflation led to a sustained period of rising interest rates. Since federal regulation placed ceilings on the interest S&Ls could offer depositors, many took their deposits out of S&Ls and moved them into money market accounts or other investment vehicles with higher earning potential. The bank run style nature of the crisis caused scores of S&Ls to fail through a mix of liquidity and solvency crises.[21]

Larger banks stepped in to fill in some of the remaining gaps in the origination market. Commercial banks originated 35 percent of single-family home loans just before 1990 – a marked increase from the more typical 20 percent share banks had held in earlier years. Shifts in regulatory policy that greatly facilitated the ability of banks to expand *interstate* allowed them to increase their mortgage activity.[22]

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[18] See, for example, "The Role of Traditional Mortgage Lenders In Future Mortgage Lending: Problems and Prospects," Kaufman, George G., Federal Reserve Bank of Chicago, 1984, available at https://fraser.stlouisfed.org/files/docs/historical/frbchi/workingpapers/frbchi_workingpaper_1984-04.pdf.

[19] See, for example, "The Federalization of Buildings & Loans, 1927 – 1940: The North Carolina Experience," Snowden, Kenneth A. and Joshua James, January 2001.

[20] "Housing Finance in the United States: The Transformation of the U.S. Housing Finance System," Joint Center for Housing Studies, Harvard University, July 2002, p. 9.

[21] For one description of the S&L crisis see, "The Federal Home Loan Bank (FHLB) System and Selected Policy Issues," Congressional Research Services, August 27, 2020. See also, "Housing Finance in the United States: The Transformation of the U.S. Housing Finance System," Joint Center for Housing Studies, Harvard University, July 2002.

[22] Rose, Peter, and Richard L. Haney. "The Players in the Primary Mortgage Market." *Journal of Housing Research* 1, no. 1 (n.d.).

## V. The rise of nonbank lenders, brokers, and subprime

Mortgage brokers have long had some role in the U.S. housing finance system, partnering with both prime and subprime and bank and nonbank lenders. As noted in the glossary, brokers function as middlemen, matching borrowers to lenders and often simplifying the process for a borrower by streamlining paperwork and administrative tasks. However, brokers played a key role in destabilizing mortgage markets during the 2000s.

The Financial Crisis Inquiry Commission (FCIC) report noted the boom in broker involvement in mortgage origination. Brokers originated or were involved in approximately 55 percent of loans in 2000 and this share of originations increased and peaked at 60 percent three years later in 2003. Although brokers partnered with lenders on all kinds of loans, they increasingly gravitated toward subprime borrowers.[23]

Nonbank lenders also increased significantly in share since the Global Financial Crisis. During the four decades preceding the 2008 crisis, the development of securitization and the originate to distribute model allowed non-bank lenders first to get a foothold and then become major players in residential mortgage lending. During the 1970s, government-sponsored entities such as Fannie Mae and Freddie Mac began securitizing and distributing mortgage-backed securities (MBS), which vastly increased the size of the secondary mortgage market. The rise of MBS's enabled a stronger "originate to distribute" model, allowing "capital-light" nonbank lenders to originate and fund mortgages with short-term funding vehicles and quickly sell these off their books.[24]

Fallout from the Global Financial Crisis accelerated the growth in market share held by nonbank mortgage lenders. The portion of mortgages originated by nonbank lenders has grown from roughly 20 percent in 2007 to over 50 percent as of a few years ago in 2016.[25] Most banks became more cautious in the wake of the financial crisis, and they pulled back from lending to riskier borrowers. Financial crisis-era litigation brought significant costs, and banks simultaneously confronted a more aggressive regulatory posture from the federal government and the states.[26] In addition, a constellation of regulatory changes, including enhanced capital requirements made mortgage lending less profitable for banks.[27] Finally, the increased use of technology, automation, and data has provided a way for nonbank lenders to gain a stronger foothold.[28] Technology has enabled a stronger direct to consumer origination channel and the ability for nonbank lenders to make parts of the origination process more efficient, from a borrower's

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[23] Financial Crisis Inquiry Commission Report, p. 91.
[24] "Bank and Nonbank Lending Over The Past 70 Years," FDIC Quarterly, available at https://www.fdic.gov/bank/analytical/quarterly/2019-vol13-4/fdic-v13n4-3q2019-article1.pdf.
[25] See, for example, Kim, Y. S., Laufer, S. M., Stanton, R., Wallace, N., & Pence, K. (2018). Liquidity crises in the mortgage market. Brookings Papers on Economic Activity, 347. doi: http://dx.doi.org.proxy.lib.duke.edu/10.1353/eca.2018.0004.
[26] "Trends in Mortgage Origination and Servicing: Nonbanks in the Post-Crisis Period," FDIC Quarterly, available at https://www.fdic.gov/bank/analytical/quarterly/2019-vol13-4/fdic-v13n4-3q2019-article3.pdf.
[27] "Mapping the boom in nonbank mortgage lending—and understanding the risks," Kim, Yok Sou, Steven M. Laufer, Karen Pence, Richard Stanton, and Nancy Wallace, Brookings, September 10, 2018, available at https://www.brookings.edu/blog/up-front/2018/09/10/mapping-the-boom-in-nonbank-mortgage-lending-and-understanding-the-risks/.
[28] "Trends in Mortgage Origination and Servicing: Nonbanks in the Post-Crisis Period," FDIC Quarterly, available at https://www.fdic.gov/bank/analytical/quarterly/2019-vol13-4/fdic-v13n4-3q2019-article3.pdf.

point of view.[29] As one example, the prominent nonbank mortgage lender Rocket Mortgage proudly describes its technology-driven, automated mortgage banking solutions as a competitive advantage and key selling point.[30]

[29] Madan, Ayush, Akshay Kapoor, and Rohit Singh, "Competing on customer experience in US mortgage," *McKinsey*, December 10, 2019, available at https://www.mckinsey.com/industries/financial-services/our-insights/banking-matters/competing-on-customer-experience-in-us-mortgage.

[30] https://www.rocketmortgage.com/.