Office of the
Comptroller of the Currency

Moments in
HISTORY

Policy Connections From the History
of the Federal Banking System

The History of National Bank Real Estate Lending: Part II (1981–2023)

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"'Mid pleasures and palaces though we may roam, be it ever so humble, there's no place like home." [1]

"Dorothy now took Toto up solemnly in her arms, and having said one last good-bye she clapped the heels of her shoes together three times, saying, 'Take me home to Aunt Em!'" [2]

Summary

In Part I of this article,[3] we described how the authority of national banks to lend against real estate collateral evolved from 1863 to 1980 and how national banks became an important source of credit to U.S. households, for whom the purchase of a home is usually the largest lifetime purchase.[4] Here in Part II, we will review the rapid pace of changes in the U.S. real estate loan market since the early 1980s as well as the implications the review has for policy questions about wealth creation and intergenerational wealth transfers.

Prominent among changes were mortgages with innovative features designed to accommodate different borrowers (e.g., loan-to-value ratio, fixed versus floating interest rate, and 15-year versus 30-year amortization schedules). However, when incorrectly managed, those features

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[1] Payne, John Howard, *Clari, or the Maid of Milan* (London: John Miller, 1823).

[2] Baum, L. Frank, *The Wonderful Wizard of Oz* (Chicago: George M. Hill Company, 1900).

[3] See Roger Tufts and Bianca Werner, "Moments in History: The History of National Bank Real Estate Lending, Part I (1863–1980)," June 2023.

[4] By mid-2023, the median sales price for a house in the Unites States was $431,000, according to the Federal Reserve Bank of St. Louis.

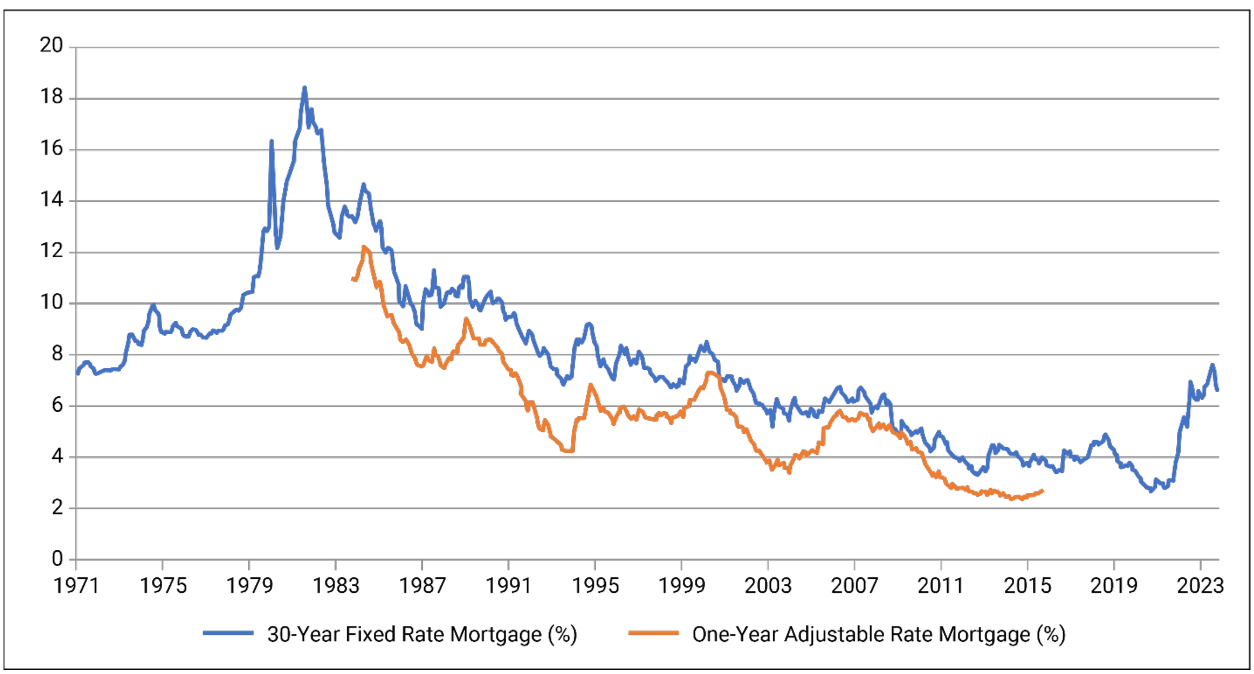
significantly increased credit risk. Imprudent lending, as well as rapid growth in the size and complexity of asset securitization markets, set the stage for the 2008 Global Financial Crisis. Both bank and nonbank originators made loans collateralized by real estate that became the dominant catalyst for that crisis.

As discussed below, the proportion of national banks' assets secured by real estate has varied within a narrow range over the past 22 years. Real estate-collateralized loans and mortgage-backed securities (MBS) were 32.7 percent of national banks' total assets in 2000 and dropped slightly to 32.5 percent at the end of 2022; the average during that period was 36.5 percent. In the same period, national banks' total assets grew from $3.42 trillion to $15.24 trillion (over 440 percent). That increase in total assets was substantially larger than the 251 percent increase in nominal gross domestic product from 2000 to 2022.

Innovations in Real Estate Lending

The late 1970s to mid-1980s were pivotal years in the evolution of residential real estate lending at commercial banks and savings associations. Unprecedented high interest rates on fixed-rate mortgages created a need for innovative mortgage products for both consumers and intermediaries. Figure 1 below shows the level of the 30-year fixed-rate mortgage interest rate from April 1971 to January 2024. Though the rate nearly reached 10 percent in November 1974, it was not until November 1978 (during the stagflation of the 1970s) that the 30-year rate persistently exceeded 10 percent. By October 1981, the 30-year rate had reached 18.45 percent. This high-rate environment set the stage for innovative mortgage products and the rapid growth in the MBS market.

Figure 1: Interest Rate on 30-Year Fixed-Rate and One-Year Adjustable-Rate Mortgages: 1971–2023



Source: Federal Reserve Economic Data (FRED), St. Louis Federal Reserve Bank

Adjustable-Rate Mortgages

In addition to showing the level of the interest rate on a 30-year fixed-rate mortgage, figure 1 includes the history of the one-year adjustable-rate mortgage (ARM) interest rate.[5] Having suffered losses on their long-dated assets that earned fixed rates lower than the interest rates paid on the liabilities funding those assets, by the early 1980s banks and savings associations were eager to transfer that interest rate risk to borrowers. To transfer the risk, lenders offered borrowers long-term mortgages in which the interest rate would reset periodically, causing the monthly payment to either rise or fall. For these ARMs, banks were free to use any interest rate index that was not within their control. As shown in figure 1, for the 10-year interval from February 1984 to February 1994, the one-year ARM rate trended downward; the one-year ARM was priced at 10.9 percent in February 1984 and gradually fell to 4.2 percent in February 1994. (Currently, most one-year ARMs are 3/1, 5/1, or 7/1 ARMs, where the first number refers to the fixed rate period of that ARM and the 1 indicates that the interest rate adjusts annually after the initial fixed rate period.)

ARMs fell out of favor after the 2008 Global Financial Crisis, a time when many borrowers had little equity in their homes and had been given ARMs with below market "teaser" rates. Those loans became unaffordable as the rates adjusted upward to the prevailing index value. As the interest rate on 30-year fixed-rate mortgages then began to drop in 2012, falling within the 3 to 4 percent range, borrowers preferred the stability of those comparatively low fixed rates. In 2021 only 4 percent of mortgage applications were for ARMs.[6] However, after the Federal Reserve Board raised interest rates in March 2022, and with the 30-year fixed rate reaching 7.62 percent in October 2023, borrowers again became more interested in the comparative affordability of ARMs.[7]

Due-on-Sale Clause

Another important change in the 1980s mortgage market was the enforcement of due-on-sale clauses. If a property is sold, a due-on-sale clause requires the borrower to repay the lender in full. Conversely, an "assumable" mortgage allows a buyer to accept responsibility for the remaining payments on the seller's mortgage. By assuming the mortgage, the buyer is, in effect, borrowing at the interest rate contracted by the seller, rather than at the then-current prevailing interest rate.

In the early 1980s the ability to allow a buyer to assume a comparatively low interest rate mortgage was highly valued. For example, 30-year fixed-rate mortgage loans originated in January 1978 had an interest rate of 9 percent. Four years later, the prevailing rate was 17.5 percent. That differential of over 8 percentage points represented an annual pre-tax cost of $8,000 for every $100,000 in unpaid principal. Notwithstanding the fact that the mortgage interest was fully tax deductible, the interest cost differential was substantial. This differential

[5] Freddie Mac stopped collecting data on one-year ARMs in 2015.

[6] Carns, Ann, "Why Adjustable-Rate Mortgages Are Still Risky," *New York Times*, June 3, 2022.

[7] After peaking in October 2023, the rate on a 30-year fixed-rate mortgage had fallen below 7 percent by December.

was, in effect, a loss to the lender, which could not re-lend the funds at the then-higher prevailing rate.

Benefitting banks, the Garn–St. Germain Act of 1982 preempted existing state laws that negated due-on-sale clauses. This due-on-sale requirement remains largely in effect today for most mortgages, although there are exceptions for certain government programs, as well as in cases of divorce and inheritance. Though the act preempted state restrictions on due-on-sale clauses, until recently the economic incentives associated with such clauses have not been as pronounced as they were in the early 1980s. This is attributable to the long downward trend in the 30-year fixed rate shown in figure 1. For many years, the rate to be paid by prospective borrowers on a new mortgage has been about the same as (or less than) the rate currently paid by the seller.[8]

However, with the substantial increase in the 30-year fixed rate after August 2021, the feature of having to pay the mortgage in full—such that the buyer must pay the current market rate for a mortgage—has been cited as a substantial impediment to the sale of existing homes. The owner of a property is similarly confronted with the dilemma that, were they to sell, any new mortgage would be at a substantially higher rate. Thus, in 2023 and in the early months of 2024 the mortgages that had advantageous rates were suppressing sales of existing homes because those potential sellers, faced with a due-on-sale clause should they sell, did not want to lose their current funding advantage. By October 2023, sales of existing homes had fallen 14.6 percent from the pace one year earlier. Table 1 shows the proportion of outstanding loans in five interest rate categories. With over 80 percent of outstanding mortgages in March 2023 having an interest rate of less than 5 percent, analysts say that sales of existing homes will likely remain comparatively low until interest rates fall.

Table 1: Distribution of Interest Rates on Outstanding Mortgages (March 2023)[9]

Interest rate	Percentage of outstanding mortgages
Less than 3 percent	23.4
3 percent to 4 percent	38.3
4 percent to 5 percent	20.2
5 percent to 6 percent	9.4
Over 6 percent	8.6

Source: Federal Housing Finance Agency, National Mortgage Database

[8] As rates generally trended downward in the 1980s, 1990s, and 2000s, borrowers refinanced higher rate mortgages into lower rates. The ability to prepay a mortgage as rates fell benefited borrowers during the many years of the general downward trend to lower rates.

[9] In October 2023 the 30-year rate reached 7.62 percent.

Mortgage-Backed Securities and Collateralized Mortgage Obligations

An MBS is simply a bond that represents ownership of a share of a pool of underlying mortgages. First created in 1968 and issued mostly by government-sponsored agencies, the volume of outstanding MBSs had grown to $12.2 trillion in 2021.[10] Beginning in the 1980s, innovative securitization structures enabled investors with differing maturity requirements to invest in a pool of loans composed of 30-year fixed-rate mortgages. While there are many variants of these collateralized mortgage obligations (CMO), their fundamental feature is that the principal payments received from the mortgages pay the CMO investors in a specified order. That is, the timing of payments to the different tranches representing the claims on the underlying pool are very different. For example, one of the CMO tranches (an early tranche) might receive the principal payments made by the entire pool of mortgages, rather than only its pro rata share of principal, and the other tranches receive only the interest on their portion of unpaid balances. This redirection of the cash flows allows some of a CMO's tranches to have a much shorter maturity, while other tranches wait to be paid the principal owed to them. Not only does a CMO structure accommodate investors with differing maturity requirements—even though the underlying assets are 30-year fixed-rate amortizing mortgages—it also allocates the risk of prepayments differentially across the tranches. If mortgage interest rates rise unexpectedly, as they did in 2022 and 2023, and the originally anticipated pace of prepayments does not happen, the maturity of the later tranches will lengthen substantially.[11]

The Increased Importance of Securitized Mortgages

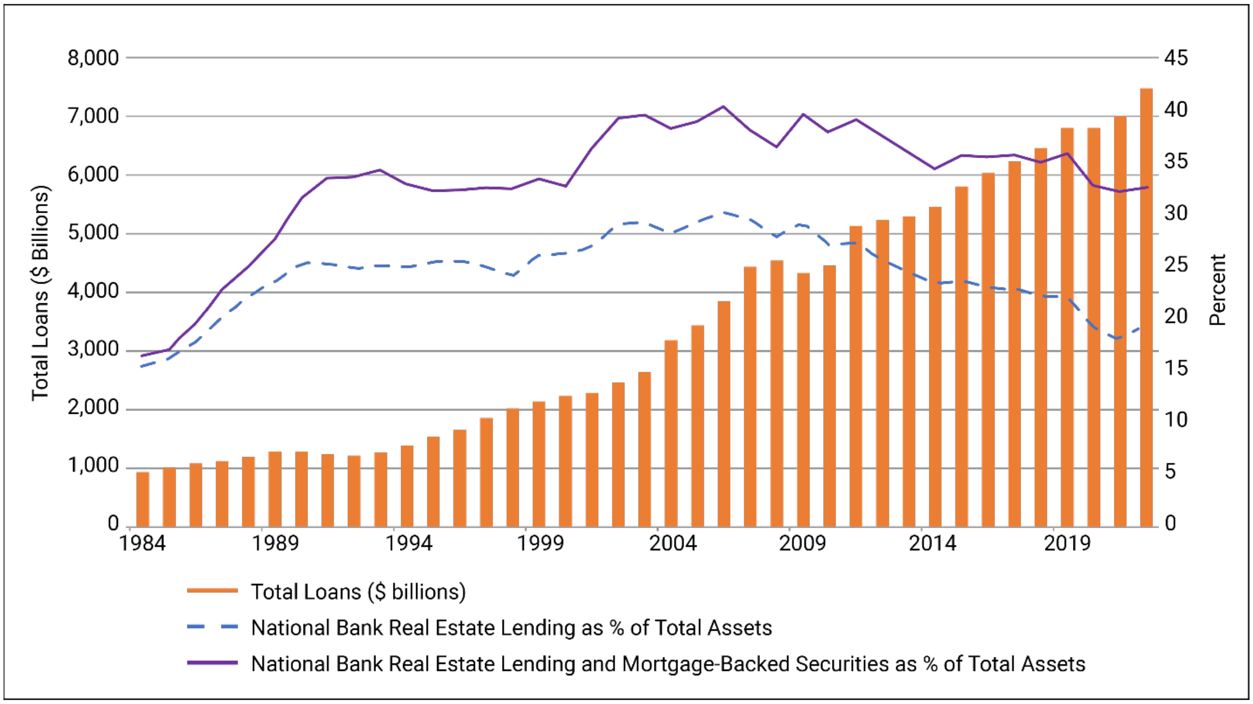
Figure 2 shows the significant effect innovations in MBSs have had on the volume of real estate-related assets on national bank balance sheets. As noted above, in contrast to a single mortgage loan collateralized by a property, an MBS or CMO represents a share of an underlying pool of mortgages that is held in a trust that issues the MBS or CMO to investors.

In 1984 direct real estate lending was 15.4 percent of total national bank assets. In contrast, the amount of MBSs and CMOs national banks owned was relatively small; the indirect loans held in the form of securities increased the ratio of real estate lending to total assets at national banks by only 1 percentage point, to 16.4 percent. Yet by 1993 real estate loans had increased to 25 percent of total assets, while the real estate-related securities contributed an additional 9 percentage points to the ratio. The divergence of the solid line in figure 2, which represents the sum of direct loans plus real estate-related securities, from the dashed line (representing only direct loans) shows the growing importance of the securitization market for real estate lending.

[10] Securities Industry and Financial Markets Association (SIFMA), "US Mortgage Backed Security Statistics."

[11] SIFMA, *Investor's Guide to RMBs & CMOs,* 2022.

Figure 2: National Bank Real Estate Lending: 1984–2022



Source: Call reports

Growth in Real Estate Lending by National Banks and Government-Sponsored Agencies

At the start of the new millennium, national bank real estate lending represented 26.1 percent of total assets.[12] Though not shown in figure 2, when total loans reached $7.5 trillion in 2022, real estate lending as a proportion of total loans had hardly changed over 22 years. However, notwithstanding the rapid growth in lending by national banks, it was the more rapid growth in investments in MBSs that added another 13.1 percentage points to the ratio of real estate-related assets to total assets. Thus, as the total assets of national banks increased substantially over two decades, it was the increased investments in MBSs that maintained the proportion of real estate-related assets to total assets at 32.5 percent in 2022 (versus 32.7 percent in 2000). In effect, the advantages of MBSs issued by government-sponsored agencies (e.g., Fannie Mae's and Freddie Mac's guarantee of repayment, the enhanced liquidity, and the alternative maturity structures) are relatively more important than in earlier decades.

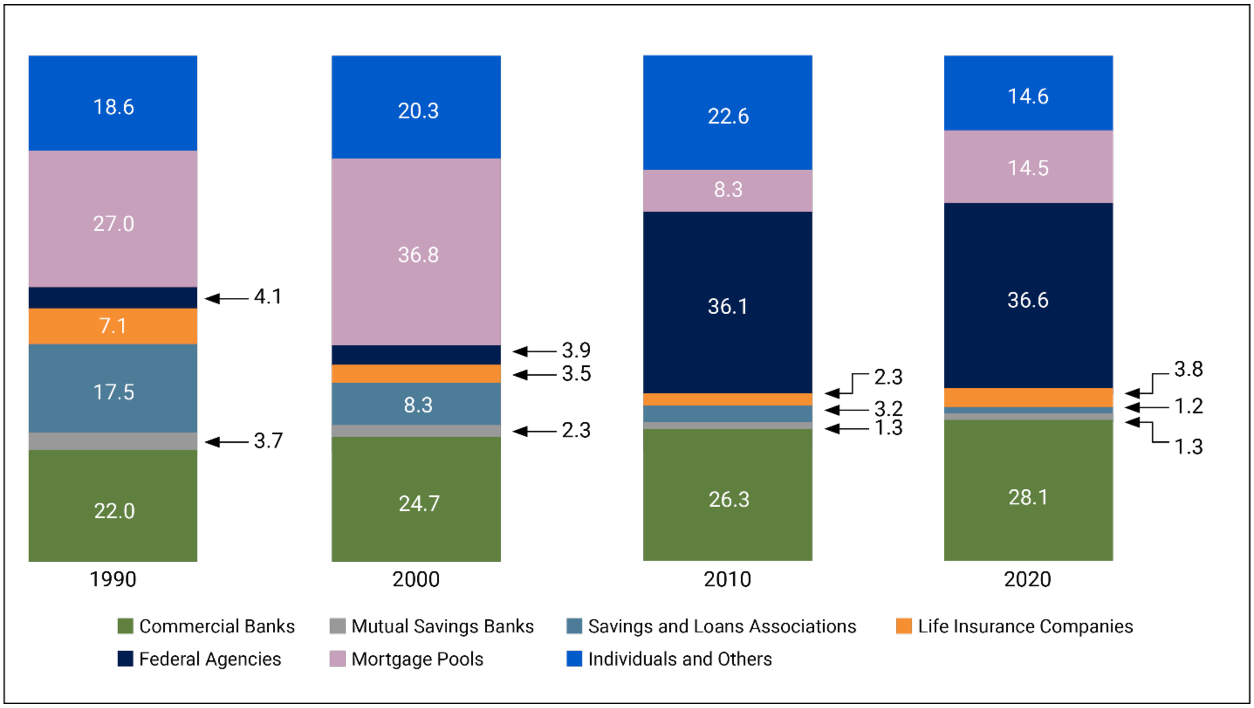
Figure 3 shows the shares of real estate lending by various types of lenders. From 1980 to 2020, total real estate lending increased 11-fold from approximately $1.5 trillion to $16.8 trillion. Apart from the shrinking share of real estate lending due to the contraction of the savings and loan sector, the data in the decades-long time series shown in figure 3 have a significant discontinuity that clouds the interpretation of the apparent changes in relative shares. The way that the balance sheet data were reported changed materially. In late 2009 the Financial Accounting Standards

[12] These mortgage loans (excluding MBS) were 40.1 percent of national banks' $2.2 trillion in total loans.

Board (FASB) modified the accounting for transfers of financial assets.[13] These changes had a substantial effect on the reported balance sheets of commercial banks, the government-sponsored agencies, and others. Simply stated, the new accounting requirements under Financial Accounting Standard 166/167 required off-balance-sheet vehicles to be consolidated on the balance sheets of these institutions. This was a significant change from the previous treatment, where securitized assets (e.g., mortgages, credit card loans, and auto loans) were treated as being sold and were not reflected on the selling institutions' balance sheets.[14]

After the accounting change, from 2010 to 2020 the sum of the shares under the new accounting standard of commercial banks and government-sponsored agencies has remained relatively constant, at 62 percent in 2010 and 65 percent in 2020.

Figure 3: Proportion of Total On-Balance-Sheet Real Estate Lending by Type of Holder



Sources: Board of Governors of the Federal Reserve System and call report data

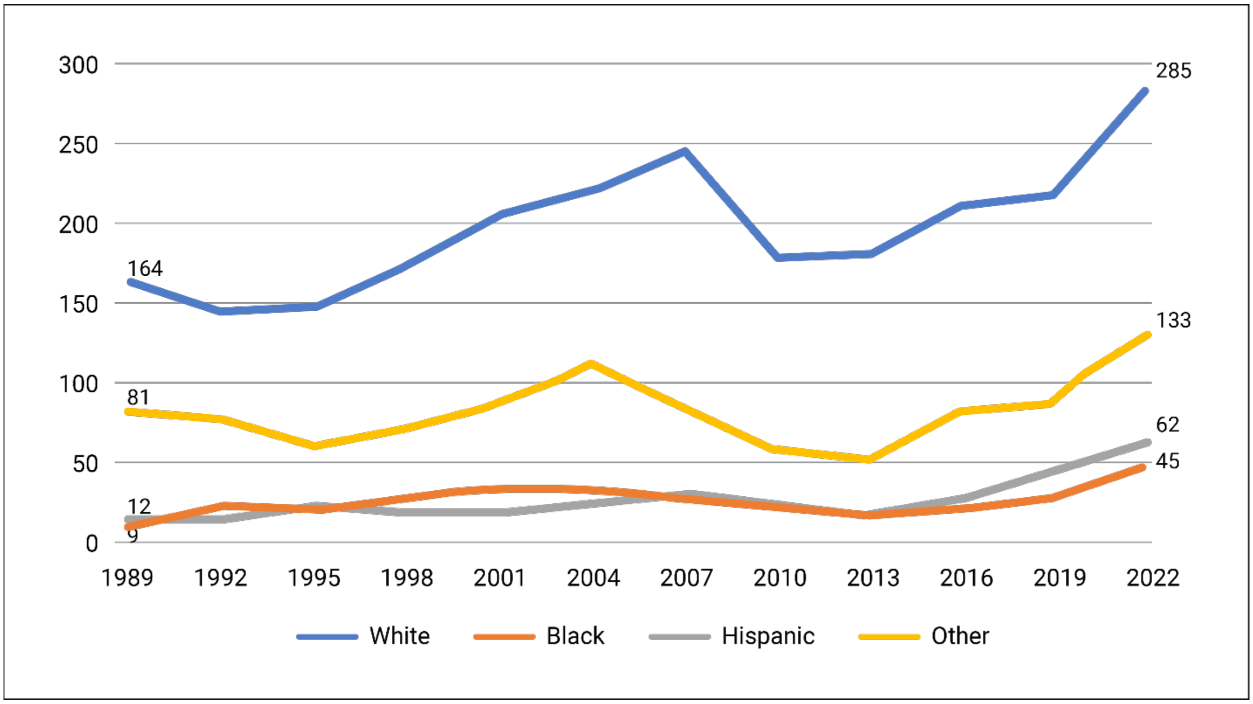
[13] FASB is the independent not-for-profit organization that establishes financial accounting and reporting standards for public and private companies and for not-for-profit organizations that follow generally accepted accounting principles.

[14] Explaining the rationale for the change, FASB said, "This statement enhances the information …about transfers of financial assets and a transferor's continuing involvement, if any, with transferred financial assets. ... This statement requires enhanced disclosures about the risks that a transferor continues to be exposed to because of its continuing involvement in transferred financial assets."

The Importance of Residential Mortgages

Recent data collected by the Federal Reserve Board in the 2022 Survey of Consumer Finances highlights disparities in the wealth of families.[15] Figure 4 shows the median level of family wealth from 1989 to 2022 measured in inflation-adjusted thousands of dollars for White, Black, Hispanic, and Other families.[16]

Figure 4: Median Family Wealth ($ Thousands)



Source: Board of Governors of the Federal Reserve System (2023)

From 1989 to 2022, the wealth of White families increased from $164,000 to $285,000 (74 percent), while that of Black families increased from $9,000 to $45,000, or 500 percent. The significant increase for Black families is largely attributable to the fact that the 1989 wealth value was low, such that the percentage change was large. Therefore, the absolute dollar amount of the gap between White and Black families, measured in inflation-adjusted dollars, increased from $155,000 in 1989 to $240,000 in 2022. Over that 33-year interval, the wealth increase for Hispanic families was comparable to that of Black families. In contrast, Asian families (which are included in the Other category) had median wealth of $536,000 in 2022. This high median for Asian families increased the median of the Other category to $133,000. The median wealth of Black families in the 2022 survey was 16 percent of the median for White families, while the median wealth of Hispanic families was 22 percent of the median for White families.

Financial Well-Being Benefits of Homeownership

[15] Aladangady, Aditya, Andrew C. Chang, and Jacob Krimmel, "Greater Wealth, Greater Uncertainty: Changes in Racial Inequality in the Survey of Consumer Finances," FEDS Notes, October 18, 2023.

[16] The category of Other comprises mixed race, Native American, Alaska Native, Native Hawaiian, Pacific Islander, and those with more than one racial identification.

In addition to measuring the differences in the level of wealth across race and ethnicity categories, the survey provides insights on the principal drivers of the change in each group's wealth. It is here that the role of residential homeownership becomes dominant for Black families. For example, the average level of wealth of Black families increased by 28.1 percent from 2019 to 2022, while the average for White families increased 19.9 percent, and the average for Hispanics increased 18.6 percent. Table 2 shows the composition of these increases. The 19.1 percent increase in net housing wealth for Black families represents 68 percent of the 28.1 percent increase. For Hispanic families, the 11.3 percent increase in net housing wealth represents 61 percent of the increase. The proportion of the overall increase in wealth of White families was smaller, at 25 percent (i.e., 4.95 divided by 19.93). These data suggest that, as it relates to long-term wealth generation, homeownership is a more important factor for Black and Hispanic households than for White households.[17]

Table 2: Composition of Growth in Average Wealth by Race and Ethnicity (2019 to 2020)

Race/ethnicity	Increase in average wealth (%)	Increase in net housing wealth (%)[a]	Increase in stock and business equity (%)	Increase in liquid assets and other wealth (%)
White	19.93	4.95	10.18	4.79
Black	28.05	19.13	6.99	1.93
Hispanic	18.58	11.31	0.71	6.56
Other	11.55	3.63	8.44	-0.52

Source: Board of Governors of the Federal Reserve System (2023)

[a] Measured as the value of the house minus loan amount.

The survey also collects information on the proportion of families that own their primary residence. Table 3 below shows homeownership rates by race. Black and Hispanic families had roughly equal rates in 2007 and 2010. Both showed decreases in 2013 and 2016, before trending upward in 2019 and 2022, which is like the pattern for White families. In general, homeownership for White families is 25 percentage points higher than for Black and Hispanic families.

Table 3: Percent of Homeownership Rates (by Race)

Year	White	Black	Hispanic	Other
2007	75.57	49.25	50.09	57.18
2010	75.33	48.50	49.06	54.89
2013	73.85	45.88	44.44	52.15
2016	72.51	44.71	45.52	53.62
2019	73.68	45.00	47.57	54.17
2022	73.15	46.34	51.09	57.34

Source: Board of Governors of the Federal Reserve System (2023)

The overall homeownership rate in the United States peaked in 2005 at 70.6 percent. Then, with the Great Recession, the rate fell to 62.7 percent by 2015.[18]

[17] Much of this difference is attributable to the fact that stock investments are a larger share of wealth for White households.
[18] Goodman, Laurie S., and Christopher Mayer, "Homeownership and the American Dream," *Journal of Economic Perspectives* 32, 1 (Winter 2018): 31–58.

In coordination with seven other agencies, the OCC issued a statement in 2022 reminding banks of their ability to establish special purpose credit programs to meet the credit needs of specified classes of people.[19] These programs enable banks to better meet the needs of underserved communities and possibly to reduce the racial wealth gap.

Even after the Great Recession of 2008, when real estate values plummeted and foreclosures spiked, people continue to aspire to own a home. In a 2017 survey by the National Association of Realtors, 86 percent of nonhomeowners indicated that they wanted to become homeowners in the future. In a 2014 survey by Fannie Mae, 90 percent of younger renters indicated that they hope to buy eventually.[20]

Though this article does not provide evidence or arguments to advocate for specific policies to address the wealth gaps or differences in homeownership rates, we believe that in developing policy alternatives, the U.S. banking agencies should consider how commercial banks and other intermediaries are uniquely able to contribute. The discussion above of the evolution of national bank real estate-related lending and investment since 1981 shows the national banking system's longstanding commitment to lending that supports homeownership.

Conclusion

While the original National Bank Act of 1863 ceded the market for real estate lending to state banks and other less regulated institutions, by 1983, after 120 years of legislative and regulatory changes, national banks fully participated in residential and commercial real estate lending. As described above, the subsequent 40 years of innovations in loan characteristics and the associated securitization structures expanded the role of commercial banks and the federal housing agencies. Though the 2008 recession led to an immediate decrease in the proportion of national bank assets composed of real estate loans and MBSs, the proportion has held steady over the past decade, a period of substantial growth in the level of national bank lending. Looking to the future, the OCC is positioned well—through its commitment to elevating fairness and addressing inequality—to support efforts to increase access to homeownership. We believe that U.S. bank regulators should support—consistent with safety, soundness, and fairness—innovative approaches to lending that meet the needs of diverse communities.

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[19] See OCC Bulletin 2022-3, "Fair Lending: Interagency Statement on Special Purpose Credit Programs." The seven other agencies in the joint statement were the Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, National Credit Union Administration, Consumer Financial Protection Bureau, Department of Housing and Urban Development, Department of Justice, and the Federal Housing Finance Agency.

[20] Goodman, Laurie S., and Christopher Mayer, "Homeownership and the American Dream," p. 42.