HOUSING ON THE INSTALLMENT PLAN: AN ECONOMIC AND INSTITUTIONAL ANALYSIS OF CONTRACT BUYING IN CHICAGO

by

LYNNE BEYER SAGALYN

B.S., Cornell University
(1969)

M.C.R.P., Rutgers University
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Signature of Author ______________________________
Department of Urban Studies and Planning
January 11, 1980

Certified by ______________________________
Bernard J. Frieden, Thesis Supervisor

Accepted by ______________________________
Robert M. Fogelson
Chairman, Department Committee

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Submitted to the Department of Urban Studies and Planning on January 11, 1980, in partial fulfillment of the requirements for the Degree of Doctor of Philosophy.

ABSTRACT

This dissertation presents an economic and institutional study of the dual housing market through a case study of the black home ownership market in transitional neighborhoods in Chicago between 1952-1968. White and black components of the housing market interact in neighborhoods experiencing racial change. Although economic incentives fuel neighborhood transition, ownership transfers in these areas must overcome the institutional factors that previously maintained residential segregation. Differential access to mortgage credit has been an important enforcement mechanism. The "redlining" policy of mortgage-granting institutions has maintained the color line by restricting lending activity to established segregated neighborhoods.

Alternative, private sources of housing credit, such as land installment contracts, have, in the past, filled the institutional credit vacuum in residential neighborhoods of impending racial change and have provided the means for black entry into white neighborhoods. The land installment contract is a legitimate, long-term finance instrument in which the seller retains title until the last payment has been made. By combining both purchase and finance arrangements, the land installment contract provided the means to transfer ownership units between black and white markets. From the speculator's perspective, the institutional arrangements of a contract sale did not differ greatly from a rental. However, it offered an important economic advantage. The contract sale yielded greater long-term profits than had the property been rented because it offered a means of locking in the initial price surges associated with limited, block-by-block ghetto expansion.

Contract sales in transitional neighborhoods in Chicago were characterized by speculative real estate activity and developed into a specialized market for the transfer, finance and management of contract ownership units. Professional real estate investors with knowledge of specialized lending sources engaged in an arbitrage process capturing the profits arising from discriminatory supply constraints on free market transfers. The source of above-normal profits was the different demand and supply relationships of the two market sectors. Speculators were able to buy in the lower-price white market for cash

and sell in the higher-price black market on credit. They were able to benefit from racial constraints on direct transfers between market sectors because they were willing to reject the professional norms of the real estate industry; however, the ability to develop a large-scale professional operation was dependent upon an ability to find a continuous source of investment capital for their activities. Speculators in this market financed the majority of the transactions with mortgage loans from institutional lenders.

Price and profit relationships in the installment contract market reflected a complex interaction of factors: a strong black demand for ownership units unavailable in existing black neighborhoods, a lack of institutional mortgage money for buyers in transitional neighborhoods, the low-equity position of the average contract buyer, the risk characteristics of the installment sale. Based on an analysis of 565 installment contract transactions, this study found that, to transfer units to the black market, buyers contracted to pay prices which were, on average, in excess of 80 percent of speculators' acquisition costs. A large portion of this transfer premium was attributable to the nature of the instrument, which in the absence of independent lending activity, allowed the speculator to inflate prices grossly. Despite the fact that profits from these sales were received over the term of the contract, the estimated annual rate of return exceeded 80 percent. These enormous returns were dependent to a large degree upon favorable mortgage finance arrangements which minimized the equity requirements and in many cases, yielded negative equities. The legal provisions of the contract further reduced the ascribed risks to the speculator from the low-equity transaction.

The major risks of contract sales were borne by the buyers. While the obvious risk was a deferred title claim, the unanticipated consequences of this feature were a lack of mobility and an inability to recapture stored equity. Homeownership through contract finance failed to provide the same type of forced savings and capital accumulation that it had for middle-class mortgagors.

The development and organization of the installment contract market in Chicago represents a specialized response to institutional discrimination and economic arbitrage incentives. A brief review of the characteristics of the transition process after 1966, at the time FHA-insured mortgage money became available in inner-city neighborhoods, indicated that the installment sale was the most suitable, but not unique, financing instrument with which to capture profits from the dual housing market.

Thesis Advisor: Bernard J. Frieden
Title: Professor of Urban Studies

PREFACE

I began my dissertation studies researching the topic of neighborhood lending risk at a time when "disinvestment" and "redlining" had become key words in the debate on the causes of neighborhood decline. After several research outlines in that direction I kept returning to the question: If institutional mortgage credit was unavailable in the central city areas of minority residence, what forms of credit facilitated the large growth in non-white, urban homeownership between 1950 and 1970? Even if lenders followed a "redlining" lending policy, an analysis of lending risks based on the experience of institutional mortgage lending would present only a partial understanding of the nature of urban lending risk. An analysis of the economic and institutional characteristics of alternative finance instruments would compliment the existing literature and provide an understanding of the costs and servicing requirements of the "risky" residential finance sector.

The topic expanded beyond the focus on lending risk due to the nature of my data source. To research the use of alternative finance instruments in urban neighborhoods I was fortunate in benefiting from the data collection activities of a major class action, civil rights lawsuit involving black purchasers in installment contract sales in Chicago, filed in early 1969 and brought to trial in 1975. Thousands of hours of research devoted to gathering and processing the voluminous original documents required for litigation had been completed long before I began my research. Without the volunteer work contributed by numerous persons, a systematic study of private, non-recorded finance arrangements in credit-short urban neighborhoods would have remained an obscure subject for "future research".

Several people helped me unravel the dynamics of housing transfers in the installment contract market, notably Richard T. Franch and John C. Tucker of Jenner and Block Law Offices of Chicago and Thomas Boodell of Boodell, Sears, Surgrue, Giambalvo, Crowley, also of Chicago. I owe a particular debt of gratitude to these persons and to the firm of Jenner and Block; by providing me with office space, clerical and paralegal assistance in the early stages of the data collection process, they continued a commitment to the contract buyers of Chicago made nine years earlier.

Others in Chicago at Jenner and Block who were generous with their time and information included Carol R. Thigpen, attorney and Maureen McDonald and Ellen Dugan, legal assistants. Without question, I have benefited from the earlier work of the Contract Buyers League and the Gamaliel Foundation. However, I remain responsible for all interpretations of the data.

My advisors, Bernard J. Frieden, Robert M. Fogelson, Langley C. Keyes, Jr. and Arthur P. Solomon, patiently listened as I reconstructed the story of installment sales and neighborhood racial change in Chicago and the wealth of detail characteristic of a case study before I could extract the important, generalizable components for an analysis. They gave me the benefit of their advice and were a source of encouragement in an otherwise lonely endeavor.

Financial support in the form of a Charles Abrams Doctoral Fellowship was provided by the Joint Center for Urban Studies of M.I.T. and Harvard University. Jan Lent, Ann Aubrey, and Irene Goodsell of the Joint Center graciously assisted me with typing and graphic displays. Penny Johnson of the M.I.T. Department of Urban Studies and Planning took particular care of the final typing and last minute revisions.

Finally, I am deeply grateful to my husband Jim for his constant encouragement during my many years of graduate study and his thoughtful questioning which contributed to this dissertation. A special warmth is reserved for my young daughter who delighted in independent play while I worked.

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CHAPTER 1

Credit for Homeownership: The Neglected Component of the Black Housing Problem

> [D]efendants [contract sellers] exploited a system of *de facto* segregation that existed in the City of Chicago [in] that by taking advantage of the scarcity of housing for negroes in the City of Chicago [they] secured unlawful advantage in the contracts executed by plaintiffs [contract buyers].
>
> Contract Buyers League v. F & F Investment, 300 F. Supp. 210 (N.D. Ill. 1969).

> Indeed, there is no difference in results between the traditional type of discrimination and defendants' exploitation of a discriminatory situation. Under the former situation blacks either pay excessive prices, or are refused altogether from purchasing housing, while under the latter situation they encounter oppressive terms and exhorbitant prices relative to the terms and prices available to white citizens for comparable housing.
>
> Clark v. Universal Builders, Inc., No. 69 C 115 (N.D. Ill. 1969), U. S. Court of Appeals, 7th Circuit, 501 F 2d 324 (1974).

INTRODUCTION

If you were white and interested in homeownership in Chicago in the two decades following World War II, mortgage finance was readily available, provided the neighborhood was not in the immediate path of ghetto expansion. Purchase and mortgage finance were separate transactions through which the buyer immediately acquired title to the property, which he then pledged as security for payment of the mortgage debt. In 1960, the terms of an FHA-insured mortgage loan written at the statutory maximum interest rate of 5 3/4 percent for 30 years, on an average $11,000 property, would have been $330 downpayment and $64 monthly for payment of principal, interest and insurance premium. The loan discount would have been approximately $330.

If you were black and interested in homeownership in Chicago in the two decades following World War II, mortgage finance was not readily available. A buyer either proceeded with a frustrating search for such funds or avoided the search costs by accepting the real estate agent's "knowledge" about housing finance. This knowledge meant that many black homebuyers signed installment sale contracts for the purchase of a home under financing terms similar to those for purchasing a consumer item such as a vacuum cleaner. Sale terms on an 8-room, 2-story brick property in a transitional neighborhood: $950 down, $130 monthly, $17,900 full price. What the advertisement did not acknowledge was that at 7 percent interest with regular payments it would take more than 20 years to complete repayment and only at that time would the contract buyer secure title to the property. If at any time prior to title transfer the buyer was delinquent, the seller had the right to repossess the property and retain all prior contract payments.

There were two housing markets in Chicago -- one for whites, the other for blacks. The dual market structure was characterized by a segregated residential pattern, defined by separate economic relationships between housing demand and supply, and supported by separate institutions, real estate actors, and available market information. There were two sets of real estate brokers, two sets of capital suppliers, and sometimes two sets of property listing books for the professionals who conducted business in both markets.

While the scale and complexity of the black market increased after World War II, its existence had long been part of Chicago's historical record. Market segmentation by race was evident as early

as 1920, five years after the Great Migration of rural blacks into that city.[1] Residential segregation continued over the succeeding decades such that by 1950, Chicago was one of the most intensely segregated cities in the United States. At that time, 81 percent of the non-white population lived in census tract areas which were 50 - 100 percent non-white; 18 percent, in mixed areas, and only 1 percent in white areas.[2]

Social and economic factors initially funneled black migrants into the older central city locations which characterized previous immigrant housing. This type of ethnic segregation was not uncommon to cities with large immigrant populations. Immigrants had traditionally clustered together because of low income, cultural heritage, desires for group cohesion and external pressures from the native majority. But with succeeding generations, residential dispersion commonly accompanied cultural assimilation and socio-economic advancement.

Black assimilation was different because it was thwarted by the reaction of a white majority based on the visible and unchangeable fact of race.[3] Associational preferences[4] and socio-economic differences[5] have explained only a fraction of the observed pattern of black residential segregation. Black segregation was not completely "voluntary", but enforced through a series of formal and informal mechanisms -- real estate and money-lending practices, restrictive covenants, and violence.

As early as 1908, a white property-owner organization had been formed to prevent negro "invasion".[6] The growing black population and

accompanying competition for living space made white property owners hostile toward the black masses which began pouring into Chicago after 1914. In 1917, a committee of the Chicago Real Estate Board translated this white hostility into an explicit policy of residential segregation. This policy -- the block-by-block negro expansion policy -- provided the framework for limiting dispersion and perpetuating the segregated residential pattern by directing ghetto expansion into adjacent blocks.[7]

The ethical acceptability of the committee's policy rested upon a negative correlation of racial change with property values. According to the committee, providing housing on a segregated basis was a "financial business proposition" which did not reflect "racial prejudice." Dispersed sales in scattered blocks meant an "unwarranted and unjustifiable destruction of values." Realtors had claimed that property values dropped 30 to 60 percent "the moment the first colored family moves into a block." To stop the scattered, "promiscuous sales," the committee recommended, and the Board adopted, that "in the interest of all" every block in the Black Belt was to be "filled solidly" before realtors could place blacks in "contiguous blocks."[8]

The realtors' expansion policy did not eliminate the racial violence which typically accompanied neighborhood transition. Violence subsided only when large-scale construction made it possible for whites in the areas bordering the Black Belt to move elsewhere. However, after 1927, the legal and more respectable racial restrictive covenant became the critical instrument to limit negro dispersion.[9] Within three years, by 1930, three-fourths of all the residential property

in Chicago was bound by restrictive covenants.[10]

By 1948, on the eve of the Supreme Court decision declaring such restrictive covenants unenforceable in the courts, historical restrictions on black access to housing in white areas formed the basis of the postwar dual housing market. Real estate brokers, money lenders, and white property owners had been conditioned to expect a pattern of "mass invasion" and declining property values (in the white market) when racial transition began. At the same point in time, the intolerable housing congestion and strong housing demand of the Black Belt provided the economic incentive for a major shift of housing units from white to black occupancy.

War-related employment and the following years of prosperity caused southern migration to increase above prewar years and the ghetto problem, already evident, was exacerbated by the war-time restrictions on new construction. Between 1940 and 1950, the black population of Chicago nearly doubled in size, from 227,731 to 492,265 persons. In the next decade, growth was slower but still enormous; by 1960, the black population had grown to 812,637 and comprised 23 percent of the city's population.[11]

DEFINING THE PROBLEM

Until 1950, population growth had been accommodated within the general outline of the classic Black Belt of the restrictive covenant area.[12] By this time, the black ghetto was severely overcrowded; 24 percent of the occupied dwelling units were overcrowded. This was six times the respective white proportion.[13] During the next decade

the postwar building boom added 450,000 housing units to the metropolitan area with one-fifth of them in the city, the remainder in the suburbs, but almost all of them were for whites.[14] Given the tight, geographically confined deteriorated housing stock, blacks were willing to pay inflated prices for property outside the ghetto, and risk violence to themselves and their property by entering white neighborhoods.[15]

The distinguishing characteristic of the black market after World War II was the expanded financial capability for homeownership. Although increased employment and war prosperity had not eliminated the black-white wage and occupational differential, it had substantially increased the purchasing power of the black household. Nonwhite male unemployment in Chicago declined from 35 percent in 1940 to 11 percent in 1950 and remained at this level in 1960. Median nonwhite family income increased from $2,500 in 1950 to $4,740 in 1960.[16] Such economic improvements created new demands for homeownership among an emerging black middle class[17] at a time when existing ghetto housing supply was overcrowded and of inferior quality.

From an aggregate perspective, the strong demand for additional housing and the increased economic resources of black households provided the push, and the growth of white suburban housing opportunities provided the pull for neighborhood racial transition. Yet there was a low probability fo a direct property transfer between a black "entering" a "new" neighborhood and a white resident-seller. Two conditions immobilized conventional real estate transactions in racially changing neighborhoods: the racial preferences of white owners and local real-

tors, and the absence of institutional mortgage money. Real estate brokers and institutional lenders, by virture of their positions as intermediaries in the transfer process, maintained the segregated residential pattern by their refusal to be the first to cross the color line. In so doing, they created a market for speculators who did not care about the expansion policy of the Real Estate Board nor its code of ethics. These persons made a speciality of opening up all-white blocks.

Speculators, acting as both broker and financial intermediary, facilitated racial transition by buying in the white market and selling in the black market. They engaged in an arbitrage process, capturing the profits arising from discriminatory supply constraints on free market transfers. The potential for above-normal profits in racial transition areas was to be found in the differential demand and supply relationships of the dual housing market. Speculators were able to buy in the lower-priced white market and sell in the higher-priced black market. However, in the absence of institutional mortgage money, some form of private finance was needed to transfer or clear the market of ownership units. Installment contract sales matched the need.

The installment contract was not the only form of private financing available to speculators. Purchase money mortgages, multiple-discounted mortgages, and kited and balloon mortgages have traditionally been used in the risky, "low end" residential market.[18] From the seller's perspective, in Illinois, the installment contract sale was far superior to these other arrangements because, unlike any mort-

gage contract, the seller did not relinquish title to the property until the last payment had been made unless mortgage conversion, at a specified conversion point, was part of the contractual agreement.

The installment contract sale was a legitimate instrument for housing purchase and finance, one with an historic tradition in Chicago. In 1919, the Chicago Commission on Race Relations noted that widespread "installment buying of homes", which had begun during the period of heavy negro migration, resulted in few contract forfeitures but that the high burden of payments meant a lack of funds for maintenance and repairs, which led to property "deterioration".[19] Even prior to the black migration of 1915, Upton Sinclair chronicled the use of installment sales among former immigrant groups in the stockyard neighborhoods. Installment sales were a form of "rental" to "make it easier to turn the party out if he did not make the payments."[20]

The distortion of the installment sale from a security agreement into what one lawyer termed "an instrument for unbridled overreaching coincided with the advance of the color line as professional real estate speculators used it to arbitrage price differentials in a racially divided housing market.[21] If there had been abuses in the past, the scale was small. Homeownership was not within the reach of many black households and the housing stock in earlier transitional neighborhoods was not as suitable for resident ownership as the stock in the 1950-1970 expansion neighborhoods. Furthermore, installment contract sales had formerly served as the low-equity finance instrument for white and

black homebuyers alike. In the postwar decades, expanding white homeownership was facilitated by the low-downpayment FHA-insured and VA-guaranteed mortgage programs. However, the underwriting criteria of these programs effectively excluded blacks from their benefits.

The primary argument against installment contract sales focuses upon their abuse in the dual market and the inequities of the contractual risk-reward relationship over time. Blacks seeking housing outside established residential areas were compelled to buy on an installment sale because it was the only means of black entry into white neighborhoods. Institutional mortgage finance was not available until the area "stabilized". Discriminatory prices resulted, not from the increment necessary to adjust for the fact that the payment was spread over time, but from the unequal bargaining position of black buyers in transitional neighborhoods.

Differential Access to Credit: A Neglected Problem

In the 1950s, differential access to credit was acknowledged as a factor affecting the extent and cost of black homeownership,[22] but it was not widely perceived as a significant part of the black housing problem. Some observers argued that differences in credit availability during this period were fully explained by disparities in the economic viability of black borrowers and property parcels.[23] Furthermore, since blacks were historically renters, the issue of credit availability affected only a small proportion of black households. The major problem for urban minorities was obvious: severe overcrowding and substandard housing conditions.[24]

Continual increases in the level of black homeownership in most urban centers between 1940 and 1960 were associated with a significant improvement in housing conditions. By 1950, 33 percent of all U. S. non-white urban households were homeowners, a percentage increase of 64 percent since 1940. During the next decade black homeownership climbed to 36 percent. In Chicago, the growth in non-white homeownership was equally impressive; by 1960, 16 percent of black households were homeowners, compared to 8 percent in 1940.[25]

The impressive rise in non-white homeownership was taken as evidence of the ability of the mortgage finance system to meet the needs of the new market despite known obstacles such as the scarcity of loan money, high interest costs, unusually large loan commissions and a restricted supply of available ownership units.[26] The scarcity of mortgage money was discounted in light of the secular increase in mortgage money available to minorities relative to past discriminatory treatment. High finance costs were attributed to lender unfamiliarity with the minority mortgage market.[27]

The positive perspective of homeownership gains also overshadowed consideration of the locational characteristics of mortgage availability for non-whites. The "common policy" of mortgage-lending institutions of refusing to finance the purchase of housing by non-whites in the white and early transition neighborhoods was considered a short-term constraint inhibiting real estate transactions.[28] By the time neighborhood "stability" had been re-established, it had become part of the black residential area but in the interim, professional real estate speculators had filled the financing vacuum.

Several field observers did not that black residential expansion was constrained by the availability of mortgage finance and purchases were characterized by inflated prices and financed with land contracts or multiple mortgages.[29] Blockbusting tactics, panic peddling salesmanship and speculative transactions in transitional neighborhoods were recognized, but the link between the real estate transfer and the means to finance the black purchase was unquestioned until the early sixties. Furthermore, contract sales were generally unrecorded. Information on the structure of transitional market profits was private and limited to individual cities. A paucity of systematic data inhibited comprehension of the scale and dynamics of the alternative market of housing finance.

Legislative recognition of discrimination in housing was slow. Only in 1962 did the prevention of discrimination in federally assisted housing become the policy of the federal government. Conventionally financed housing transactions were not covered until the Fair Housing Act of 1968, but certain categories were still excluded. Not until the landmark U. S. Supreme Court decision of Jones v. Mayer, in the same year, was all discrimination, private as well as public, banned in the sale and rental of property.[30] But the Jones decision, based on an interpretation of Section 1982 of the Civil Rights Act of 1866, explicitly stated that Section 1982 "is not a comprehensive open housing law" and that it "does not deal specifically with discrimination in the provision of services or facilities in connection with the sale or rental of a dwelling...It does not refer explicitly to discrimination in financing arrangements or in the provision of

brokerage services."[31]

Above all, the problem of differential access to credit was bound up in the dynamics of the dual housing market as black sought to expand the boundaries of their segregated residential area. Direct, individual acts of discrimination were legally distinct from their aggregate effects upon market structure and the resultant demand and supply relationships governing price in the black market. The "race inflated purchase prices" and "costly financing terms extracted from Negro purchasers" in their efforts to "acquire better housing within the existing supply,"[32] did not fit the traditional definition of discriminatory seller conduct. This traditional conceptual model of discrimination visualized the offender (white seller or speculator in the instant case) dealing with both races and treating one less favorably than the other. A seller's behavior was considered discriminatory and illegal if _he_ handled whites differently than blacks. This definition implicitly accepted the conceptualization of a single competitive model of market behavior. If the black purchase price reflected "what the market will bear," it was a fact of economics, not discrimination, that the black buyer in a changing neighborhood might pay more than the white buyer.

"Taking Advantage": An Expanded Definition of Discrimination

Traditional acts of discrimination are less frequently observed in the dual housing market. Discrimination more commonly manifests itself in the institutional characteristics of the housing market which define the choices and costs of black housing search. The effect of aggregate acts of traditional discrimination is reflected in the dual

market structure. The black market "will bear" a higher price because blacks lack equal bargaining power due to restricted entry to the larger white market.

The gate keepers of racial barriers are the market discriminators in the traditional sense. The list of white market restrictors is long and the activities of its actors, a pyramid of support for residential segregation. From the actions of those who refused to provide housing on the basis of race (real estate agents, developers, private home-owners), to the courts which gave effect to restrictive covenates, to lending institutions and institutional investors (insurance companies, perhaps FNMA) who imposed stricter requirements for the acquisition of black assets, and to governmental agencies (FHA, VA) which stimulated or sanctioned such activities, the dual market developed. Although these restrictive activities are theoretically within the traditional definition of discriminatory behavior, the causal link between discriminator and victim is usually remote, with the discriminatory practice operating more in the aggregate than in individual cases.[33] The effects of institutionalized discrimination are self-reinforcing since they can affect buyer behavior prior to entry into the housing market. Segregated housing patterns and other forces that deny equal access to housing, finance or information greatly reduce the probability that black households will search for housing in white markets.[34]

The first judicial recognition of the <u>effects</u> of discriminatory market structure followed shortly after the <u>Jones v. Mayer</u> decision. In 1969, a number of blacks who purchased homes on installment con-

tracts in changing neighborhoods in Chicago sued their sellers in federal court for "overcharging" them because of race. The suit did not allege that the sellers had individually created the conditions of the dual housing market in which they operated, but that they had "exploited" this market situation and by selling at "higher prices and more burdensome terms than similar property sold to whites," had earned unjust, discriminatory profits.[35] Relying heavily on the Jones v. Mayer decision, the Northern District Court of Illinois, in a ruling on defendants' (contract sellers) motion to dismiss, attempted to fit the buyers' claim into the traditional definition of discrimination when it stated that the sellers' conduct would have violated Section 1982 of the 1866 Civil Rights Act if it could be shown that they had sold property to blacks at higher prices than similar property was or would have been sold to whites.[36]

This class action lawsuit, Contract Buyers League v. F & F Investment, was radically different from the Jones v. Mayer case. In order for the actions of the contract sellers to fit within the traditional definition of discrimination, it was necessary to make the inference that the sellers would have treated whites differently, since actual sales or attempts to sell to whites by defendants did not have to be shown. As one writer subsequently emphasized, it would be impossible to make this inference. If a "white price" was derived through the use of "comparable" sales, the economic analysis involves the assumption that the seller would have treated whites differently. But in the context of the dual housing market, that assumption was invalid. If whites could obtain housing for less in other areas, no

white sales would occur in the black market as long as unfulfilled black demand created numerous black buyers willing to outbid whites for properties in changing neighborhoods. If the seller just accepted the highest prices in the black market, as in an auction (absent a price-fixing conspiracy), he would have done nothing to cause the prices to be different from those in white areas. A finding of discrimination was unlikely to be made since a lower price in the white market showed only that there was traditional discrimination in the market as a whole, not that the individual seller in the black market so discriminated.[37]

Six years later in 1976, in the third longest trial in the Federal District Seventh Circuit Court, the jury, in finding for the defendant-sellers against the contract buyers, relied upon the traditional definition of discrimination. They did not accept the argument that the effects of the dual housing market were discriminatory. Jurors did not believe that there was "one [market] for Whites and one for Blacks with both seeking the same or similar housing in the same area." It was "one market with the classic mercantile aspects -- Supply and Demand." "They were not in competition to buy; therefore, how could you claim Whites paid less." Economics, not civil rights, prevailed; sellers "would have charged their own mother the going rate."[38]

The significant departure from the traditional theory of discrimination had occurred two years before the CBL trial in the Contract Buyers League companion suit against sellers of new homes on installment contracts, Clark v. Universal Builders, Inc.[39] In the

appeal decision of that case, the Federal Court of Appeals for the Seventh Circuit set out the standards of liability of the "exploitation theory of discrimination."[40] This new theory imputes liability to parties who do not themselves discriminate in the traditional sense but rather exploit a "situation created by socioeconomic forces tainted by racial discrimination." The court held that it would be a violation of Section 1982 of the 1866 Civil Rights Act for a seller of new housing to take advantage of a racially discriminatory housing market situation to extract from black buyers "prices and terms unreasonably in excess of prices and terms available to white citizens for comparable housing."[41]

In the Clark decision, the court recognized the burdensome effects upon the entire housing market caused by the aggregation of individual acts of discrimination. It noted that the housing shortage was "triggered not by economic phenomena but by a pattern of discrimination," and that the purpose of Section 1982 was to "eliminate all discrimination and the effects thereof in the ownership of property." The "exhorbitant prices and severe long-term land contract terms" perpetuate a system of racial residential segregation" by tieing blacks to housing in segregated inner-city neighborhoods "from which they can only hope to escape someday without severe financial loss." "[E]xtracting from blacks resources much needed for other necessities of life" reduces the probability that they will escape from a position of social inequality. Furthermore, by providing an "unattractive yet alternative" form of housing purchase, defendant-sellers' sales on a

land installment contract "deflects or forestalls" overt discrimination by others and encourages such discrimination.[42]

These two civil rights cases were initiated by the Contract Buyers League, an organization founded in 1967 by a group of Jesuits and college students for the purpose of renegotiating the installment contracts and obtaining mortgage financing.[43] The activities of the League attracted national publicity and focused attention on the bounds of prudent speculative profits in discriminatory housing markets.[44] They also attracted the interest of the Nixon administration, which led the U. S. Justice Department to file an amicus curiae brief, the first of its kind to be submitted at the trial level, during consideration of the motions to dismiss in Contract Buyers League v. F & F Investment.[45]

CONFLICTING VIEWS ON THE COMPETITIVE NATURE OF THE HOUSING MARKET

Because the traditional conceptualization of discrimination focuses on individual acts of differential treatment, there has been minimal research directed toward quantifying the discriminatory costs arising from institutional discrimination, in particular, differential access to housing finance. This represents a significant gap in our understanding of the role of race in urban housing markets because differential access directly affects the competitive position of the black household in the metropolitan market and the probability and costs of black homeownership.

The main body of economic research has focused on the question: Do black households pay more, consume more or less housing than similarly situated white households? It has generally been assumed that individuals possessed equal bargaining power in a single, competitive market. Despite the fact that there has been general agreement regarding the empirical facts amassed to date -- that blacks have in the past paid higher prices than whites for the "same" bundle or received a smaller bundle for the same price -- there is no such consensus on the causes of such price differentials. This is partially attributable to a critical methodological problem of much early research. These studies often did not have an adequate specification of the housing bundle being purchased. Nonetheless, disagreement on the causes of these white-black price differentials often reflects a different conceptual approach to defining the role of race in urban housing markets and the results of these analytical studies may not provide an unambiguous statement of the cause(s) of the differentials. The division of opinion, between orthodox and dual housing market theories, parallels the judicial conceptualization of traditional and exploitation theories of discrimination.

Orthodox economic models provide a theory of housing price determination and consumption with an extra term -- the discrimination coefficient. Race affects this coefficient either through pure individual price discrimination or individual preferences for housing in neighborhoods with certain social compositions.[46] In those models of urban residential choice which incorporate discriminatory behavior, price differentials result because white sellers of housing have an

aversion to dealing with blacks and will do so only if they receive compensation higher than what they would receive if they sold to a white.

The primary orthodox treatment of race in economic models of the housing market portrays housing exchanges taking place in a competitive market with transfer dependent only upon the satisfaction of individual tastes. Under the most common set of assumptions, whites prefer segregation and blacks prefer integration. Therefore, white households pay a premium to live apart from blacks and blacks pay a premimum to live close to white neighborhoods. Prices for whites are higher in the white interior than at the white-black boundary, and prices for blacks are higher at the white-black boundary than in the black interior. Different preference assumptions produce different price patterns,[47] but unlike pure race discrimination, price differentials always operate on a neighborhood level rather than on an individual basis. Segregation results from voluntary self-selection based on preferences for homogeneity, not discrimination.[48] Market imperfections -- racial discrimination and neighborhood externalities -- affect the pattern of housing transition,[49] cause temporary disequilibrium lengthening the time necessary to achieve equilibrium, but in the long-run, competition eliminates any discriminatory price differentials.[50]

The alternative conceptualization presented by the dual housing market hypothesis challenges the assumption of a single, competitive market. Instead, the urban housing market is conceptualized as a series of submarkets segmented by race and income. The observed neighborhood price differentials between black and white markets are attri-

buted to collusive behavior among white actors in the housing market, which restricts equal access to housing units and forces the price inside the black submarket above the price for similar housing in the white submarket.[51] Although the market must be highly organized for this pattern of exclusion to be effective, historical restrictions on black access to housing opportunities in white neighborhoods have been open and explicit.[52] Given this type of noncompetitive market structure, blacks must pay a premium to transfer units from the white to the black market. The size of this premium depends upon the extent of prejudice, the organization of the market and the mechanisms available to enforce market separation.[53] The racial difference between markets, not individual households, determines price. The pattern of higher ghetto neighborhood price differentials predicted by the dual housing market hypothesis may resemble the pattern predicted under the individual preference hypothesis. This occurs under two situations: if blacks prefer segregation and whites prefer integration or are indifferent or if blacks have a stronger preference than whites for segregation. Therefore, a comparison of these price differentials would not allow the researcher to distinguish between alternative explanations.[54]

The underlying assumption of black preferences for segregation does not conform with survey research indicating that blacks favor living in integrated neighborhoods. Surveys in 1963 and 1966 revealed that 64 and 68 percent of the respective random samples of blacks favored living in integrated neighborhoods. In comparison, in both years 20 percent or fewer black respondents favored all-black neigh-

borhoods.[55]

The assumption of a single, competitive market implies that a black household is able to buy the same housing bundle in a black neighborhood as a white household in a white neighborhood. Access and purchase is therefore singularly dependent upon price and individual ability to pay for the bundle. Under the individual preference hypothesis, if whites prefer segregation and blacks prefer integration, blacks would be willing to pay more than whites for housing at the white-black boundary. But if non-pecuniary causes of limited access preclude blacks purchasing equivalent housing bundles, then again, the comparison of black-white price differentials would not allow the researcher to distinguish between alternative hypotheses. The existence of a black-white price differential in border neighborhoods is not an unambiguous statement of preferences for integration. The price effects in competitive economic models attributed to black tastes for integration may reflect prior restrictions on housing choice. The willingness of blacks to spend a disproportionate amoung of their income on housing in transition neighborhoods may therefore be misinterpreted as preferences for living among whites,when in fact it may be a measure of the demand for better physical housing and public services that are unavailable in black neighborhoods, rather than a social preference for white neighbors.

This "better services" argument is confirmed in at least one study of desegregation in Chicago's suburbs. The report concluded that "Negro families do not move to accomplish integration but rather to obtain good housing in a good neighborhood with good schools,

institutions and facilities."[56]

Orthodox models assume that institutional relationships for the supply of credit in housing markets are fixed and therefore do not interact with the determination of housing price or consumption in the models. But these relationships do change in neighborhoods undergoing transition. By abstracting from housing purchase agreements, under the assumption of perfect capital markets, these models implicitly assume that the effects arising from differential access to credit are neutral. But by one researcher's estimate, these factors have had a significant effect on the extent of black homeownership.[58] Moreover, when differential access affects the type of sales transaction as well as the price, as evidenced in the installment contract market, empirical analyses which do not consider the purchase arrangement may fail to distinguish the cause of the higher observed prices paid by blacks for "comparable" bundles.

The assumption of market competition in orthodox economic analyses of race and housing choice has precluded consideration of the relationship between market organization and discrimination. The models do not consider if and how racial discrimination and existing patterns of segregation affect housing searches, access to credit and, hence, the set of purchase opportunities. Since these factors do affect black access to white neighborhoods, comparisons of "equivalent" housing bundles are conceptually flawed because they are not comparable bundles. Thus, dual housing market researchers emphasize that the relevant comparison is the cost of black preferences in the white market and the cost of white preferences in the black market. Per-

fectly constructed empirical analyses of price differentials have only an indirect bearing on housing policy issues because discrimination takes on many forms and price analyses do not explain the mechanisms of differential treatment in the marketplace. Most significantly, conventional price analyses fail to measure the full costs of restrictions on residential choice and market segmentation. These include the non-price risks attached to alternative forms of housing credit.

OWNERSHIP TRANSFERS IN THE DUAL HOUSING MARKET: A CASE STUDY OF THE INSTALLMENT CONTRACT MARKET IN CHICAGO

The causes of black-white price differentials must be examined through a broad consideration of the housing supply adjustment process in the segregated housing market, one which examines the competitive nature of the marketplace and the barriers to open housing opportunities. A theory of discrimination in urban housing markets should be able to explain what gives white households the power to exclude blacks from their neighborhoods. The enforcement mechanism in competitive orthodox economic models is the white buyer's segregation premium (individual preference hypothesis) or white seller's discrimination premium (seller's aversion hypothesis). In both cases price controls entry and the higher cost theoretically discourages a black from buying into a white neighborhood. This would imply a spatial pattern of segregation first by income and then by race. Yet these models are inconsistent with the empirical existence of a single ghetto concentration and the absence of higher income black households hopping over poorer white households.[57]

The dual market perspective recognizes in theory and empirical research that each market is characterized by separate supply and demand functions and possibly different suppliers and institutions. Although it posits racial price differentials to be a function of discriminatory processes segmenting the market and constraining direct black entry into white neighborhoods, the main body of empirical research has focused on explaining these racial price differentials on the basis of premiums attached to particular characteristics of the housing bundle. As an alternative explanation to the orthodox model of a single, competitive housing market, the dual hypothesis must explain the difference between a temporary disequilibrium which modifies price relationships and the existence of a separate,permanent market structure. As a guide for policy prescription, it must explain how institutional market barriers develop, enforce segmentation by limiting mobility, and why competition fails to eliminate these barriers to household mobility.

This dissertation analyzes the linkage between institutional discrimination in the housing market and the market costs of discrimination through a case study of the development and economic behavior of the alternative homeownership market in racially changing neighborhoods in Chicago. The two segments of the dual housing market interact in neighborhoods experiencing racial change. Although economic incentives fuel neighborhood transition, ownership transfers in these areas must overcome the institutional factors that previously maintained residential exclusion. Differential access to mortgage credit has been an important enforcement mechanism. Alternative sources of hous-

ing finance, such as land installment contracts, have, in the past, filled the credit vacuum in residential areas of impending racial change and have provided the means for black entry into white neighborhoods.[59] An analysis of the characteristics of housing transfers between white and black markets, through the medium of contract sales, provides a means of assessing the costs arising from institutional constraints on residential choice.

Chicago was not the only urban area where installment contract sales characterized ownership transfers between racially divided housing markets. Published reports indicated such activity in Detroit, Baltimore, Denver, Albany, Portland, and Madison.[60] However, the fact that installment contract sales were rarely publicly recorded has hindered systematic study of their use. Prior studies that have analyzed property transfers and price dynamics in racial transition neighborhoods have been based on sample data from recorded property transfers and stated revenue stamps. This data source generally produced a biased sample since they rarely included the speculator-black buyer installment sale transactions which comprised the majority of transactions during initial neighborhood change.[61] Furthermore, federal revenue stamps on acquisitions in transitional neighborhoods were often biased upward to conceal the speculator's real purchase price.[62]

By focusing the research on Chicago, this case study is able to overcome the above problems because the data collection process for the Contract Buyers League litigation produced a unique, large body of information on installment contract sales. These installment sales

were transactions on 1-4 - family homes which took place between 1952 and 1968.

As a case study of the dynamics of racial change, this dissertation follows a long historical tradition of studies which have examined the relationships between ghetto expansion and housing prices in the city of Chicago. The conclusions of Chicago's research history have ranked correlations of ethnicity and property values whcih subsequently found expression in FHA Underwriting Manuals, defined the neighborhood life-cycle hypothesis, contributed key elements to the filtering concept, stimulated the concept of the dual housing market, and provided a laboratory for the individual preference hypothesis which has led to the development of the arbitrage model of neighborhood succession.[63]

Market Arbitrage: The Role of the Speculator

Collusion among realtors, sellers and money lenders to limit the availability of housing to blacks in order to profit from artificially stimulated higher prices has commonly been rejected by economists because of the inherent instability of collusive agreements among market participants.[64] Restrictive agreements collapse because there are always some actors who are willing to break the agreement to benefit from potential windfall profits.

The activities of blockbusters and speculators who arbitrage racial preferences and transaction price differentials between white and black households have always been considered proof of the instability of alleged collusive agreements. In competitive models, speculators function to clear the market by transferring units between sub-

markets segmented by incomes, tastes, and race. This type of arbitrage is considered to be a natural part of the filtering mechanism. It is assumed that competition resulting from high profits in this transaction eventually eliminates any racial price effects.

The persistence of excess profits in speculative transactions in racailly changing neighborhoods suggests that competition does not completely eliminate the particular market mismatches between housing demand and supply, or that speculators possess specialized knowledge or resources which inhibit entry of sufficient competitors to affect price-setting behavior, or both. As a consequence, speculators in these situations possess a degree of monopoly power which allows them to benefit from constrained black mobility due to discriminatory access.

There is little systematic research on the operations of speculators with which to assess the competitive nature of the arbitrage process and the barriers to direct transactions. The information which does exist suggests that speculative real estate transactions result in an expansion of the black residential area but that speculators earn extremely large profits.[65]

Chapter 2 of this dissertation addresses this issue by focusing on the structure and operations of the installment contract sales market. How extensively were contracts utilized in racially changing neighborhoods? Who were the contract buyers? Why did they purchase on an installment contract? Who were the speculators? Why did they sell instead of rent the property? How much competition existed in this market? Were there barriers to entry?

Involvement of Financial Institutions

Since homeownership represents the acquisition of an expensive, durable commodity, as well as a long-term investment, most households depend upon some form of long-term credit arrangement to finance the purchase. Although overt discrimination against blacks in the provision of mortgage or credit was not uncommon in the early 1950s, institutionalized discrimination affecting mortgage loan criteria has been a more pervasive form of discrimination differentially impacting black households.

The line between overt and institutionalized discrimination is often unclear because loan evaluation is a function of borrower credit and property characteristics, and both sets have been affected by discrimination and patterns of residential segregation. Lenders can practice overt discrimination while appearing to be objective by relying on screening devices or formal underwriting criteria that have been heavily influenced by biased, but commonly accepted, standards of property evaluation and by the results of past institutionalized discrimination in other economic markets. Examples of this procedural bias have been found frequently in the housing finance literature: the FHA "economic life" criteria for neighborhooods, discounting income from secondary jobs and working wives, rejecting credit references from auto loan or small-loan agencies. Procedural bias causes the objective risk of a black household with the same income as that of a white to be higher on average. Therefore, nondiscriminatory application of the above type of underwriting standards to mortgage applicants often results in racially discriminatory lending patterns.[66]

Financial institutions have played a more obvious role in maintaining non-economic barriers to mobility between white and black housing markets. Institutional support for residential segregation is manifested in the common withdrawal of mortgage credit in racially "threatened" neighborhoods or by the refusal of lenders to finance the purchase of black "entry" into a white neighborhood. The effects of this form of discrimination are self-reinforcing because they can affect buyer behavior prior to entry into the housing market and greately reduce the probability that a black household will search for housing in white neighborhoods.[67]

Financial institutions directly contributed in two ways to the creation and growth of the installment contract market. Procedural bias and the policy of "no integration" loans helped create the arbitrage market in racial transition areas. Many of these lenders then supported the speculator's activities by providing mortgage finance for contract transactions. Chapter 3 examines how these institutional factors shaped and supported the development of the installment contract market. It then questions the nature of the linkage between real estate speculation in contract sales and institutional lending. By addressing these issues, the chapter examines the barriers to direct transactions between white and black households in changing neighborhoods.

Price, Profit and Risk

Research on black-white price differentials has primarily been concerned with the overall level of housing prices in the ghetto and

in all-white neighborhoods. This focus results from the concern of economic models with long-term equilibrium effects. This type of analysis fails to examine the short-term market structure and dynamics of racial transition which often result in temporary price deviations in transitional areas. The fact that the long-term price relationships in the area may equal those in all-white neighborhoods does not negate the importance of the short-term discriminatory effects. These factors have their greatest impact in the market for owner-occupied units.

The dynamics of ownership transfers are important because the characteristics of the transfer generally depend on the form of long-term credit, and affect both the equity recovery of the white resident-seller and the long-term finance commitment of the black purchaser. If institutional mortgage finance is not available prior to and in the early stages of transition, white resident-owners, by selling to speculators at a discount, fail to recover their full home equity. Although the seller can personally finance the sale by taking back a purchase money mortgage or using an installment contract, the deferred payment and long pay-back period subsequently constrain his housing purchase decision. Entering black households must rely on the more expensive non-institutional forms of housing finance which generally inflate the price and debt burden.

The impacts of credit availability on ownership transfers are important because homeownership has been the traditional form of forced savings and capital accumulation for the majority of low- and middle-income households. Equities in single-family owner-occupied

structures accounted for nearly one-half of all the wealth of the lowest income group in 1962.[68]

The characteristics of ownership transfers between white and black households in changing neighborhoods are an important part of the dual housing market hypothesis. There has been little systematic research of these transfers which has included consideration of the credit supply constraint on the form as well as price of the transaction. Chapter 4 attempts to fill this gap in our knowledge about urban housing markets. It analyzes two related issues: What is the form and size of the premium required to shift units between housing market segments? How much of this premium is associated with the contract finance mechanism?

Information on speculative property transfers in these changing neighborhoods represents a prime source of data for analyzing the discriminatory costs of restricted access because price comparison in the white acquisition-black sale transaction is based on the identical bundle of housing services. Without the need to standardize the complex, heterogeneous characteristics of housing services, the research can focus on price differentials and "turnover" profits which arise from differential market demand and supply relationships.

Because the installment sale transaction includes finance arrangements, sale payment is spread out over the term of the contract. For the buyer in Illinois, there are two major risks to this arrangement: deferred title ownership, and lack of equity rights with rapid eviction in the event of default. These nonprice terms of sale place the contract buyer in an inferior position compared to the purchaser

in a deed and mortgage transaction.

The risks of contract nonpayment have been the primary justification given by contract speculators for the inflated installment sales prices. While the terms of the contract included additional payments for interest, contract speculators maintained that it was insufficient for the low-equity transaction, and that the inflated price only capitalized the finance and holding costs of the risky investment. Nevertheless, speculators in this arbitrage market operated under extremely favorable legal and financial arrangements. How did these factors alter the real risk exposure of contract speculators? What was the payment experience of contract sales? These issues are examined in Chapter 5.

The development and organization of the installment contract sales market in Chicago represented a specialized response to institutional discrimination and economic arbitrage incentives. How characteristic was the response? Are the lessons of this market tied to the specific financing instrument? What changes occurred in the transition process with the availability of FHA-insured mortgage finance? Through an analysis of the FHA underwriting policy reforms, Chapter 6 argues that the abuse of the installment sale was the precursor to the abuse of FHA financing. Prior to the availability of FHA-insured mortgages in transition neighborhoods, the land installment contract was the most suitable, but not unique, finance instrument with which to capture profits from the dual housing market.

CHAPTER 2

The Market of Installment Contract Sales

And they [the lending institutions] didn't even bother to check our credit, or how much we had to put down. So we had to buy on contract. It was contract or not at all.

Contract buyer, Chicago.
J. M. Fitzgerald, "The Contract Buyers League".

In September, 1960, the Carpenters purchased a 40-year-old, two-flat masonry building for $26,000 in West Garfield Park, Chicago. They paid $1,250 downpayment and signed an installment contract which required them to pay the $24,750 balance over a 25-year period. After 50 percent of the principal had been paid, the contract allowed them the option of obtaining a mortgage from the seller. The contract specified $175 per month for payment of the principal and interest (at 7 percent); with payments for taxes and insurance, their monthly obligation totaled $200. Unknown to them at the time, the seller had recently purchased the property from an Italian resident-owner for $14,200 and had secured a mortgage from a savings and loan institution for $15,000. After signing the mortgage agreement, the seller's cash investment totaled $147; after the closing of the installment sale, within three weeks of his purchase, the seller had already secured a cash return of $1,103. Over the term of the contract he could expect a monthly gross cash flow of $59 (the difference between the monthly contract and mortgage obligations). The net paper profit, after accounting for financing costs and repairs and estimated selling costs, was 67 percent.

At the same time, in Washington Heights on Chicago's south side, the Carters purchased a new 5 1/2 room single-family home for $21,450. After being told by the sales agent that they had insufficient

collateral for a GI mortgage, they paid a 7 percent downpayment and signed an installment contract for the outstanding balance of $19,950 payable at $125 per month for principal and interest (at 6 1/2 percent) for approximately 28 years. With payments for taxes and insurance, their monthly payments totaled $150. On paper this represented a gross profit of 43 percent for the construction-selling company; after a 26 percent addition for overhead and profit, the deferred net profit was 14 percent. These paper profits did not present the full picture of investment return. At the time of buyer possession, the selling company's direct cash investment totaled approximately $96.50 and would be paid back after just four months of contract payments.

Land installment contracts (LICs) are officially titled "articles for agreement for warranty deed", "trustee's deed" or simply "contract for deed". Although legally viewed as a "wholly executory contract of sale" with the subject of the bargain to be transfered only upon fulfillment of all contract conditions, installment contracts are functionally financing instruments with the seller as financier freed from lending limitations and conventional mortgage strictures common to savings and loan associations.[1]

Land installment contracts used in Illinois commonly waive a long list of conventional buyer ownership rights. Although the buyer is entitled to federal income tax deductions for property taxes and interest payments,[2] the seller retains title ownership until payments are complete. There are practically no statutory provisions constraining land contracts except for the usury rate governing mortgage loans.

The seller's most strategic tool is his ability to utilize any remedy the law provides in the event of the buyer's default on the contract.[3] Invariably this means that the seller prefers the statutory forcible entry and detainer (eviction) procedure, originally designed for trespassers and tenants in default of rent. In Chicago, this procedure was swift and streamlined.[4]

Due to the advantages the installment contract offers the seller -- control over loan collateral and rapid remedies in the event of default -- it has long been regarded as the alternative to mortgage finance for high-risk properties and low-equity purchasers, a temporary financing vehicle in periods of tight money, and a means to get around the legal restriction on loan interest rates. A contract could be made to yield a return greater than that allowed by the state usury ceiling by inflating the sale price to be financed at the legal rate. The contract could then be sold at a discount to provide the amount of dollars equivalent to a cash sale and a yield to the purchaser equivalent to a low downpayment second mortgage.[5]

The installment contract is the choice instrument of the seller, not the buyer-borrower, since it offers the latter few advantages over a mortgage. The unsophisticated buyer-borrower in an installment contract transaction not only fails to acquire title ownership and equity rights, he loses the institutional protection against "bad" investments customary to mortgage finance. There are four major influences, generally absent from the installment sale transaction, that protect the middle-income buyer with mortgage finance. The first of these influences is the FHA, which protects the middle-income

buyer by requiring that quality be commensurate with price. The second beneficial influence is the lending institution, which while protecting its own interests, insures that the buyer does not excessively overpay. The third influence, an active market in housing and credit supply, allows an unknowing buyer to "step in and take the 'going rate' without having to do any serious bargaining" because "knowledgeable participants" influence the market. The entire system of common law and statutory protection, which has developed over the years to help buyers in their dealings with mortgage lenders, is the fourth institutional influence.[6]

The main argument against installment contract sales focuses on its abuse as a financing instrument, the purchase price distortions and the inequities of the risk-reward relationship over the term of the contract. Discriminatory prices result not from the increment necessary to adjust for the fact that the payment is spread over time, but from the unequal bargaining position of black buyers. This position results from the segregated character of the housing market, and strong demand among blacks for additional housing units. Comparisons between "comparable" units in white and black markets are comparisons between two different opportunity sets: the black market with its strong demand and artificially short supply and the white market with its relatively lesser demand and absolutely greater supply. Simple economics would dictate a price differential between black border areas (and pockets of new housing) and the white market at large.[7] Regardless of internal competition in the black market, as long as the two markets remain effectively separate through restricted access,

and black housing demand does not match the available housing stock, intermediaries who shift units between markets may earn "discriminatory" profits.[8] Such profits do not depend upon traditional acts of discriminatory pricing by the seller. The seller only needs to charge "what the market will bear." Installment contract sales provided a convenient instrument for earning such profits but their source lay within the dual structure of the market.

THE MARKET OF INSTALLMENT CONTRACT SALES

Financing Neighborhood Racial Transition: Installment Sales of Existing Homes

For two decades following World War II, contract sales were widespread in transitional neighborhoods contiguous to Chicago's expanding black ghetto. More than just numerous individual transactions between white sellers and black buyers, contract sales were dominated by speculative real estate activity and developed into a specialized market for the transfer, finance and management of contract-ownership units. Professional real estate investors with knowledge of specialized lending sources brokered racial change, selling through newly organized or established local real estate agents. Contract properties were managed individually or through arrangements with specialized management companies. A small "secondary market" for this risky contract paper provided a speculator with a means to liquidate his holdings.

Even the conventions of the contract market differed from those in stable real estate markets. Property "scouts" specialized in

"finding" properties for speculators and real estate agents often received amortized sales commissions contingent upon continued buyer payment performance. Multiple transfers among straw parties artificially increased the recorded turnover of property and inflated prices for federal revenue tax stamps[9] generated an appearance of price appreciation. These actions were taken to inflate the public record of market activity prior to black purchase and support higher property appraisals for greater financial leverage. Coupled with the ownership of property in blind land trusts,[10] they revealed a pattern of concealment which tacitly acknowledged manipulation of the market.

Was land contract financing the exclusive means of housing finance in racially changing neighborhoods? Ideally, one would approach this question by looking at the distribution of housing credit by type of credit across neighborhoods representative of all stages of racial transition and then ask: What are the characteristics of those neighborhoods (properties and buyers) where installment sales are preeminent which would explain the difference in the source of housing credit? Given this type of information, it would then be possible to begin to make inferences about the connection between neighborhood racial transition and the supply of housing finance. It is impossible to gather such data for the time period in which contract sales were a dominant feature of the Chicago black housing market. Installment contract sales were rarely recorded at the time of purchase. The standard contract form contained a clause probibiting recording of the contract in the Office of the Recorder of Deeds;[11] in addition, the buyer generally lacked the legal knowledge to give

public notice of his interest in the property. This non-recording feature of contracts biases systematic investigation of the range of housing finance sources across neighborhoods.

The data for this study overcomes this past constraint by drawing upon the litigation research generated by the two class-action civil rights suits filed by the Contract Buyers League early in 1969 in Chicago.[12] The trial data has yielded a unique body of information for a case study of installment contract finance. The main limitation of this data source is the inability to draw a random, representative sample from the population of contract sales. This arises from the nature of the legal proceedings. As defined by the U. S. District Court for the Northern District of Illinois, Eastern Division (Chicago), the "universe" of 2,600 contract sales is significantly smaller than the true population of sales within the 1952-1968 time frame.[13] Nevertheless, this "universe" does include the largest speculators and those with continuous sales throughout the most active period of contract activity. The analysis of characteristics of contract sales in the following section is based upon a sample of 419 transactions from this universe.[14]

To conform to the data available, the initial question must be rephrased: What is the distribution of contract sale neighborhoods by stage of racial transition? Table 2-1 presents this distribution by census tract neighborhoods following Duncan and Duncan's six-stage classification of neighborhood racial succession.[15] More than 65 percent of the sample contract transactions were in neighborhoods of recent racial transition (invasion or penetration). Fourteen per-

TABLE 2-1

Distribution of Installment Contract Sample by Stage of Racial Succession 1950-60, 1960-70

Stage of Racial Succession*	Number	Percent
All White	59	14.2
Penetration	28	6.7
Invasion	245	58.9
Early Consolidation	14	3.3
Consolidation	54	13.0
Late Consolidation	10	2.4
Piling Up	6	1.4
TOTAL	416	100.0+

SOURCE: Otis D. Duncan and Beverly Duncan, The Negro Population of Chicago: A Study of Residential Succession (Chicago: University of Chicago Press, 1957). Definition for Penetration not specified.

+ Total may not add to 100 due to rounding.

* Properties identified by census tract classified by stage of racial succession for two time periods, 1950-60 or 1960-70, depending upon the transaction period. The 1950-60 classification was used for purchases between 1950-62; the 1960-70 classification for those purchased between 1963-68.

All White: no change in racial status of census tract.

Penetration: noticeable change from complete white occupancy pattern; but less than 250 non-white residents in 1960 (1970); increase in absolute number and percent non-white population between 1950-1960 (1960-1970); percent non-white greater than 0.7% in 1960 (1970).

Invasion: less than 2% of population non-white in 1950 (1960) and less than 250 non-white residents in 1950 (1960); 250 or more non-whites in 1960 (1970).

Early Consolidation: 2% or more of population non-white in 1950 (1960); 250 or more non-white residents in 1960 (1970) but less than 250 in 1950 (1960).

Consolidation: less than 80% of population non-white in 1950 (1960); 250 or more non-white residents in 1950 (1960) and 1960 (1970).

Late Consolidation: 80.0-97.4% of population non-white in 1950 (1960); 90% or more of population non-white in 1960 (1970); 250 or more non-white residents in both years.

Piling Up: 97.5% or more of population non-white in both 1950 (1960) and 1960 (1970); 250 or more non-white residents in both years.

cent of the sample sales occurred in all-white neighborhoods which subsequently experienced transition. In comparison, only 17 percent of the sample transactions involved properties located in established black neighborhoods (consolidation, late consolidation, piling up). As shown in Table 2-2, the use of installment contract sales in transition neighborhoods was most pronounced in the west side sector of black expansion and during the 1950-1960 decade. During this time period, contract sale activity appeared in approximately 87 percent of all invasion tracts in Chicago; the only invasion area noteably unaffected by contract activity was Hyde Park, where there was an organized effort to keep speculators out of the area.[16] In contrast, contract sales were evident in only 34 out of 86, or 40 percent, of the 1960-1970 invasion tracts. While the west side continued to experience heavy contract sale activity between 1960-1970, LIC activity appeared in only selected south side 1960-1970 transition areas, mainly those community areas that had experienced some transition in the earlier decade.

Expansion of the black residential area between 1950-1970 represented a continuation of the 1940-1950 path of invasion on the west side into the Near West Side and North Lawndale communities, and on the south side,the communities of Oakland, Kenwood and Woodlawn. If this expansion continued on the path typical for Chicago, it would follow the routes of rapid transportation in the direction of better housing. Both Wallace and deVise demonstrated that of all neighborhoods contiguous to the prewar Black Belt, expansion proceeded in those areas of least ethnic resistence and of relatively better

TABLE 2-2

Distribution of Invasion Census Tracts
1950-1960, 1960-1970, by Geographic Sector, City of
Chicago Compared with the Presence of Installment
Contract Sale Activity

	1950-1960		1960-1970	
	Number	Percent	Number	Percent
Total Number of Invasion Census Tracts				
City of Chicago	69	100.0	86	100.0
North side	1	1.5	6	7.0
West side	29	42.0	22	25.6
South side	39	56.5	58	67.4
Invasion Census Tracts with Evidence of Installment Contract Activity				
All Areas	60	87.0	34	39.5
West side	28	40.6	13	15.1
South side	32	46.4	21	24.4

NOTE: Distribution of installment contract sales activity from CBL Universe of contract properties; the assumption is that the sale took place in decade of initial racial transition.

housing quality. The comparison made by deVise of 1950 white contiguous census tracts which were consolidated black settlements by 1960 with those remaining white revealed several interesting facts:[17]

- Three-fifths of the highest quintile of income tracts, as compared to only one-fourth of the lowest income tracts, became succession tracts.
- Two-thirds of the highest rent, contiguous tracts in 1950 were added to the Negro residential area by 1960. In contrast, only 16 percent of the lowest rent tracts underwent transition.
- The percent of dilapidated units in contiguous succession census tracts averaged 3 percent in contrast to 5 percent for contiguous nonsuccession tracts.
- The ethnic groups most resistant to change were the Polish and Italian foreign-born.

While deVise noted that higher-income persons were able to move more easily, Wallace and Philpott argued persuasively that white restrictive action, noteably racial covenants and racial violence, historically conditioned and mediated the terms under which Negro expansion took place. Since violence often accompanied expansion of the Black Belt, poor housing did not constitute a goal worth fighting for.[18]

Installment contract sales occurred in areas of early postwar ghetto expansion, Near West Side, Oakland, Woodlawn and Kenwood, but the scale of sales activity appears to have been minor. Compared to the community areas of subsequent heavy contract activity, North Lawndale, East and West Garfield Park, Greater Grand Crossing, Englewood, and West Englewood (east of Ashland Avenue); the housing stock in the former areas was primarily multi-family structures which presented fewer opportunities for nonprofessional, resident ownership (Table 2-3).

TABLE 2-3

Selected Characteristics of Transition Community Areas, City of Chicago, 1960

Community Area	Percent Population Nonwhite			Percent Owner-Occupied Units 1960	Percent Units, One-Two Flat Structures, 1960	Percent Units, in Structures with More than 5 Units, 1960
	1950	1960	1970			
I. 1950 EARLY TRANSITION AREAS*						
East Garfield Park	16.7	61.5	98.0	13.4	22.9	47.0
North Lawndale	13.1	91.1	96.3	17.9	25.9	38.9
Kenwood	9.7	83.9	78.9	8.6	15.2	74.8
Greater Grand Crossing	5.8	85.8	98.1	34.9	53.5	29.3
Englewood	10.5	68.9	96.4	26.8	52.4	25.2
Roseland	18.4	22.6	55.1	61.3	85.4	8.0
II. 1960 EARLY TRANSITION AREAS						
West Garfield Park	0.0	15.8	96.8	20.5	31.0	40.8
South Lawndale	2.0	5.9	10.3	39.8	60.3	10.4
South Shore	0.2	9.6	69.0	21.1	25.8	63.3
West Englewood**	6.0	11.7	48.3	50.9	78.0	7.8
Washington Heights	0.2	12.5	74.7	74.5	85.4	7.2
II. 1970 EARLY TRANSITION AREAS						
Humbolt Park	0.1	0.6	19.4	35.3	50.0	19.8
IV. OTHERS						
1950 PAST TRANSITION						
Near West Side	40.9	53.8	72.2	9.6	24.2	51.5
Fuller Park	49.7	96.0	96.9	28.4	51.2	11.4
Woodlawn	38.8	89.1	95.8	8.8	15.0	71.0
Oakland	77.4	98.2	98.9	5.9	14.5	72.9
1960 PAST TRANSITION						
Chatham	0.8	63.7	97.5	5.9	45.6	40.2
1970 PAST TRANSITION						
Auburn Gresham	0.0	0.2	68.7	53.1	66.8	23.5
Austin	0.1	0.0	32.5	37.7	53.3	33.2

SOURCE: Local Community Fact Book Chicago Metropolitan Area 1960, E. M. Kitagawa and K. E. Taeuber, eds. (Chicago: Chicago Community Inventory, University of Chicago, 1963).

* Early transition community areas defined as having a black population equal to or more than 5 percent but equal to or less than 30 percent in the stated year.

** Technically West Englewood was in early transition by 1950 but there had been a clear dividing line (Ashland Ave). between white and black West Englewood; 1960 transition is a more realistic classification.

The most significant sustained period of contract sales began about 1955 on the west side in North Lawndale and on the south side in Englewood. Figure 2-1 provides a map of contract activity by Chicago community areas. Almost 89 percent of the universe contract sales were concentrated in six community areas: North Lawndale, East and West Garfield Park, Englewood, Greater Grand Crossing and West Englewood. Contract sales in North Lawndale and the Garfield Park areas accounted for 94 percent of the west side activity; sales in Englewood, West Englewood and Greater Grand Crossing, 75 percent of south side activity. During the years of peak activity contract sales advanced into sections of Austin, South Lawndale, Fuller Park, South Shore, Chatham and Auburn Gresham, but these areas did not experience a significant volume of contract sale activity (Table 2-4).

Since installment sales were utilized primarily as a finance vehicle in transitional neighborhoods, the geographic center of sales activity shifted over time. On the west side, the center of the market shifted from North Lawndale to East Garfield Park to West Garfield Park. On the south side, Englewood remained an active center for contract sales while expansion proceeded into Greater Grand Crossing.

The installment sales market was not a short-term phenomenon. It flourished until 1964, at which time its functional importance declined in proportion to the redirected and increased activity of the government-backed mortgage sector in inner-city neighborhoods. Over time, contract buyers bought into better neighborhoods with less substandard housing, fewer overcrowded units and higher income profiles.

Figure 2-1. LOCATION OF INSTALLMENT CONTRACT SALES OF EXISTING & NEW HOMES, CHICAGO, 1952-1968

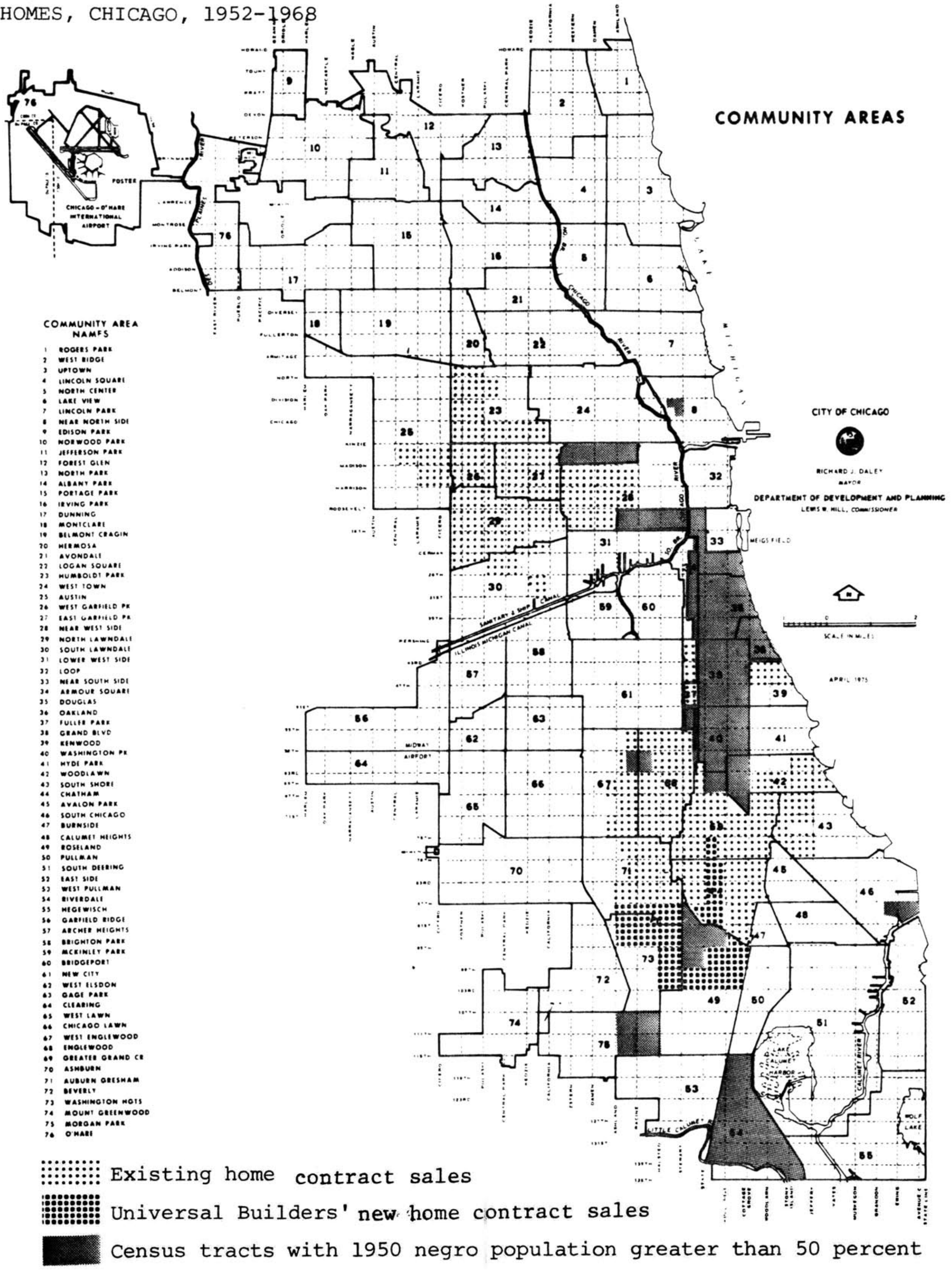


TABLE 2-4

Selected Characteristics of Census Tracts with Major Contract Sale Activity Between 1955 - 1965 by Community Area

	Community Area						
	North Lawndale[a]	East Garfield Park[b]	West Garfield Park[c]	Englewood[d]	Greater Grand Crossing[e]	West Englewood[f]	City of Chicago
Period of Initial Contract Sale Activity	1955	1958	1959	1956	1959	1958	--
Population Characteristics (1960)							
Percent Negro, 1950	5.1	0.6	0.4	3.9	0.1	1.9	14.1
Percent Negro, 1960	93.0	28.5	18.5	52.1	62.6	22.4	22.9
Median family income, 1959 ($)	5428	5432	5896	5886	6086	6264	6738
Community area index (100)	109	116	96	106	98	94	--
Chicago city index (100)	81	81	88	87	90	93	100
Percent families, income < $ 3,000	20.9	17.4	17.4	17.3	16.1	15.5	13.6
Percent families, income > $10,000	9.5	10.5	14.3	14.0	14.2	16.0	21.3
Housing Characteristics (1960)							
Percent owner-occupied	21.1	15.8	21.2	30.5	30.0	43.5	32.7
Percent substandard	8.6	16.9	7.9	9.4	11.9	4.7	14.0
Percent 1 + persons per room	33.5	26.2	18.6	19.6	19.4	12.0	11.7
Median gross rent ($)	100	87	91	98	96	93	88
Chicago city index (100)	114	99	103	111	109	105	100
Median value: owner units ($)	16100	13100	15200	13800	14300	11900	18000
Chicago city index (100)	89	73	84	77	79	66	100
Number of universe contract sales	262	455	719	249	64	77	--
Universe contract sales, all census tracts, community area 1952-1968	372	508	757	331	105	87	--

SOURCE: Local Community Fact Book Chicago Metropolitan Area 1960, E. M. Kitagawa and K. E. Taeuber, eds. (Chicago: Chicago Community Inventory, University of Chicago, 1963).

Census tracts in community areas with heavy contract activity:

a. North Lawndale tracts: 444, 445, 450A, 451, 460, 462.
b. East Garfield Park: 363Z, 364, 365, 366, 367, 368, 369, 375Z.
c. West Garfield Park: 348Z, 349Z, 350, 351, 352, 353Z, 354.
d. Englewood: 871, 879, 880, 881, 882, 883, 884.
e. Greater Grand Crossing: 890, 899, 900.
f. West Englewood: 858, 859, 867Z, 868.

By 1965, with peak activity past, contract sales were more frequent in older, consolidated black neighborhoods on multi-profit properties, those properties with previous contract sales or prior rentals.

Capitalizing on a Dominant Market Position: Installment Sales of New Homes

Installment contract sales were not confined to the existing-home sector of the black housing market. A major expansion in the stock of newly constructed ownership units for blacks in Chicago occurred between 1960-1970. For the city as a whole, 9,661 black ownership units were added during this time period.[19] While it is not possible to determine the exact proportion of these homes sold on contract, the data on new-home installment contracts from the Contract Buyers League files provides a lower estimate. Between 1957 and 1969, Universal Builders (UB), the defendant in Clark v. Universal Builders, Inc., constructed and, in a joint venture with eight land companies,[20] sold 1,291 new single-family homes on the south side. All but 18 of these homes were sold with installment contracts.

Universal was not the only developer selling new homes in the south side market. Trial testimony, local newspaper articles and advertisements and research reports indicated that there were at least five other subdivision developers. While other builders may have sold some proportion of their units on contract, there was no indication that any other builder relied exclusively on installment sales. One small builder known to have used installment sales did so only when the buyer failed to qualify for either FHA or conventional mortgage finance.[21]

The finance of new homes with installment contracts by Universal Builders did not serve as an alternative to mortgage finance for high-risk borrowers. Universal Builders established a non-negotiable, minimum downpayment for each model which was due before the purchaser could obtain possession of the house.[22] UB further required completion of a credit application. During the first CBL trial of the new homes case, Universal's legal defense did argue that contract buying reached a larger market because downpayment requirements were generally lower than conventional mortgages, and unlike mortgage lenders, UB considered a wife's income. But they did not argue that the higher prices of contract sales were necessary to compensate the seller for greater borrower risks.[23] The evidence was against this. Of the 325 contract buyers in the initial plaintiff class, the downpayment averaged 10 percent or $2,563; the range extended from 4 percent to 46 percent ($900-$14,000). In a 1961 letter to their mortgage source requesting reconsideration of loan terms, Universal Builders boasted of the large downpayments made by the contract buyers, downpayments "substantially above that current in the trade."[24]

Nor was Universal Builder's use of installment contract financing dictated by racial transition. Installment sales on new homes were most frequently utilized in established black neighborhoods. Table 2-5 displays the distribution of new home contract sales by 1960-1970 census tract classification by stage of racial transition. Less than 10 percent of the homes constructed between 1957 and 1969 were in transitional neighborhoods.

TABLE 2-5

Distribution of New Homes Sold on Installment Contract by Universal Builders by Census Tract Stage of Racial Succession 1960 - 1970

Stage of Racial Succession	Number	Percent
Invasion	68	5.27
Early Consolidation	51	3.95
Consolidation	251	19.44
Late Consolidation	802	62.12
Piling Up	119	9.22
TOTAL	1,291	100.00

NOTE: For definitions, see Table 2-1.

After 1950, FHA-insured, and particularly VA-guaranteed mortgage loans, had become increasingly important sources of funds for black homebuyers.[25] Universal Builders did not sell on installment contract because these government-backed mortgage loans were unavailable in the neighborhoods in which Universal was building. Surf Builders, a small competitor building in the same neighborhoods as Universal Builders, sold between 150-200 homes between 1963 and 1967, 33 percent of which were financed with FHA-insured mortgages.[26] Additional evidence of FHA loan activity in these neighborhoods was available from the discovery process for the CBL trial.[27] In every census tract in which Universal Builders sold homes with installment contracts, cash sales had been financed with FHA or VA mortgages.

Assuming that the average contract buyer could have qualified for an FHA or VA mortgage, and given the advantages of a mortgage, how did Universal persuade buyers to purchase on an installment contract?

One argument for UB's successful use of contract financing is market power. Table 2-6 shows that Universal's construction accounted for approximately 19 to 32 percent of the total Negro owner-occupied units constructed, respectively, between 1960-1964 and 1965-1968 in the five south side communities in which Universal was most actively building. In UB's major local market, Washington Heights, it held a substantial market share, 45 percent, of all new homes built between 1960-1968. Furthermore, UB's share of the market may be understated for two reasons. First, homes constructed by UB were single-family units, while the figure for Negro owner-occupied units represents dwelling units and may include two-family homes which were still being built during this period. Second, the proportional distribution between subdivision and individual custom-built homes is unknown and the former, not the total figure, is the most appropriate to gauge UB's market position.

From the mid-1950s onward the gap between market supply and demand for new homes among blacks grew as demand, stimulated by rising incomes and more stable employment, confronted continuing restrictions on the supply of new housing for blacks in metropolitan Chicago. These supply restrictions were attributable to four commonly recognized, interrelated problems: (1) the difficulty of site selection and large-scale land assembly imposed by segregation forces; (2) the

TABLE 2-6

New Owner-Occupied Units 1960-1968, Chicago
South Side Communities: Chatham, Roseland, Greater Grand
Crossing, Auburn Gresham, Washington Heights, Morgan Park

Combined Community Areas	1960-1964	1965-1968	Total
Total Built Owner-Occupied	4069	1326	5395
Negro owner-occupied	3544	1166	4710
Percent Negro owner-occupied	87.1	87.9	87.3
Universal Builders Construction	689	372	1061
Percent of Negro owner-occupied	19.4	31.9	22.5

Community Area	1960-1968 Total Negro Owner-Occupied Units (a)	1960-1968 Units Constructed by Universal Blds. (b)	Column (b) as a Percent of Column (a)
Chatham	844	295	35.0
Roseland	1110	324	29.2
Greater Grand Crossing	237	18	7.6
Auburn Gresham	492	59	12.0
Washington Heights	1141	512	44.9
Morgan Park	886	60	6.8

SOURCE: Chicago Association of Commerce and Industry, Community Area Data Book, 1970 Census 4th Count by Community Area (Chicago: CACI, 1972).

limited availability of construction financing due to a reluctance of investors to confront the above problem, and the belief, based on the stereotyped image of low socio-economic status and unstable employment patterns among black households, that this market, unlike the white, new-home market, was too limited in size to support anticipated sales; (3) the general reluctance of savings and loan associations to write mortgages for black households; and (4) the marketing problems due to constraints on mortgage funds.[28] The bulk of new homes constructed for black households consequently resulted from custom construction by small-scale builders on owner-purchased lots. This began to change in the late 1950s, early 1960s.[29]

Universal's subdivision activities represented a major development in the black market of new homes regardless of the number and scale of other competitors. Their marketing brochures proclaimed:

> In 1958 the city of Chicago issued more building permits to Universal Builders, Inc. than to any other single builder. Thus, because of its position as one of the really large builders in this area, Universal is able to buy materials in huge quantities at the most favorable price on the market. Furthermore, this large-scale construction program enables Universal to make the most economical use of equipment. These savings and these economies are passed on to Universal home buyers, resulting in better buys at lower prices.[30]

Nevertheless, UB's successful selling strategy was designed around the fact that black households commonly held fewer liquid assets than white households with equivalent incomes. They offered a no-money down or "thrift lay-away" plan for homeownership; prospective purchasers could save toward the full downpayment requirement without delaying construction progress on their future home. Buyers would contract for a home and make an initial payment. After half of the

total downpayment had been paid, Universal started construction of the home. The home would be ready for occupancy when the total downpayment had been paid.

Installment contract sales on new homes resulted from the dominant market position of this large-scale producer in a small market. In this advantageous position, Universal Builders refused to sell homes by any means other than the installment contract. The combined output of small-scale competitors during any one period was probably insufficient to meet demand. While these competitors built in the same communities, each operated for only a few years. No competitor actively built homes in the black market in Chicago during the entire thirteen years of UB's tenure on the south side. Furthermore, only Universal Builders offered multiple locational choices spanning five south side community areas.

It has been easier to establish the civil rights case against sellers of new homes. There have been fewer problems with establishing "comparable" prices and defining excessive profits compared to the existing home case.[31] The most significant fact establishing traditional discriminatory liability has been Universal Builders' own dual market building operations. In the late 1950s, UB constructed 25 comparable homes in the town of Deerfield, Illinois, and, pursuant to identical joint venture agreements, sold them to whites. The net profit of these homes averaged 12 percent, compared to 22 percent for comparable homes sold to blacks on installment contracts during the same period.[32]

This study focuses upon the existing home submarket. Activity in these transition areas at the white-black boundary has been the primary source of stock expansion for the black housing market. New construction has not been a major source of stock additions. Despite record levels of new construction in the black market in the decade between 1960-1970, the 9,661 owner units newly constructed and occupied by blacks in Chicago comprised only 26 percent of the net change in the black housing stock. Over 28,000 net additions to the owner-occupied stock resulted from the transition from white to black occupancy.[33]

MARKET ACTORS

Contract Buyers

Subscribers to the American Dream, recent migrants and native black Chicagoans desired the stability, status and neighborhood amenity symbolized by homeownership. Stability implied a home of one's own "while young enough to pay for it" and correspondingly, minimal housing expenses when old, rental income from apartments in two- or three-flat buildings, and family security.[34] Most homebuyers sought to escape the overcrowded ghetto and to benefit from better housing and municipal services, and a better neighborhood environment for child rearing.

The immediate reasons precipitating homeownership were often compelling. Demand pressures from migration and natural population increases coupled with geographic supply constraints created a condi-

tion of pent-up demand. Between 1940-1950, the Negro population of Chicago increased by 77 percent; between 1950-1960, the population expanded by another 65 percent. By 1960, the total population increase was just short of 535,000 persons, nearly double the 1940 enumeration. By 1956, the total physical renewal programs of the city of Chicago had displaced 23,894 families and 7,101 individuals, 67 percent of which were estimated to be nonwhite.[35] This relocation figure represented more than 11 percent of the 1950 Negro population.

In the decade following World War II, locational choices outside the ghetto satisfying the above demand factors were limited to those city neighborhoods vacated by whites moving to the suburbs. Homes in black suburban developments were generally not available until the late 1950s, and then on a relatively small scale. While custom building existed, this served an even smaller segment of the black market. The choices for improved housing were few:

> For most poor black families uprooted by urban renewal, as well as for those seeking to get out of other overcrowded black communities, the choice was a simple one: accept segregated public housing, challenge segregationist practices in white ethnic neighborhoods and depend on police protection, or attempt to buy one of the solidly constructed homes rapidly becoming available through a combination of panic peddling and the exodus of white ethnics to the suburbs. Many...chose to follow the blockbuster.[36]

Many landlords in the black market refused to rent to families with children.

> I had taken one kid from my sister-in-law. We had one kid of our own and I was pregnant with another. We had to get another place. The owner of the apartment [we were renting] didn't want kids in his place. Everywhere we went, they did not want kids.[37]

Often while apartment hunting a household unwittingly found itself "voluntarily" committed to purchasing a home; the brokers who handled rentals also negotiated contract purchases, and the commission benefits of the latter were not insignificant incentives to influence the brokers' marketing strategies.

If the traditional values attendant upon homeownership served as idealistic sources of appeal, real financial constraints were paramount for the majority of searching households. The determining factor to buy on an installment contract was often the low downpayment. FHA financing was not available in these changing neighborhoods and, given distortions in purchasing power in the black contract market, few households had the assets for a conventional mortgage, which required a 20 to 30 percent downpayment.

The decision to purchase appeared as the best alternative in an unsatisfactory situation. In retrospect, buyers of existing homes felt victimized because of their race.

> [I] knew I was overcharged from the beginning but everything was high and I needed someplace.
>
> [I] knew the house wasn't worth it -- I was only interested in the downpayment.
>
> [I was] told by my lawyer the price was too high and advised not to buy but did so anyway since I was tired of paying almost twice as much for rent which gave me nothing.
>
> This was the best building we had seen. It weren't looking too hot. But it was the best we had seen for the money we had. He was only asking $500 or $1,000 down.[38]

There is little systematic information available now with which to construct a socio-economic profile of contract buyers at the time of purchase.[39] This is unfortunate because it limits the

study's ability to refute the excessive borrower-risk argument made by sellers in defense of the inflated contract prices. Nevertheless, sample data coupled with information from CBL literature and field interviews, and commentaries on contract buying indicate that, at the time of purchase, the average contract buyer of an existing home was less then 40 years of age, married with three children, a southern migrant, and employed in a blue collar or laboring job.

Almost all buyers of existing homes had formerly been renters. For 139 of these buyers information on previous rental expenditures permits a comparison with contract expenditures. Monthly contract payments for buyers on the west side were 88 percent higher than former rentals and 51 percent higher on the south side. Most buildings sold on contract were two-flat structures. When an adjustment is made for rental income expectations, the calculus of the buyer's decision becomes evident. Monthly payments for homeownership (principal and interest only) on average did not change a buyer's contractual housing expenditures.

Utilizing 1960 census tract median income for families in constant dollars (1957-59) as a proxy for buyer income, it is possible to estimate the contract payment burden. For west side buyers, this ratio of monthly payments to income averaged 33 percent (without the rental adjustment); for south side buyers, 30 percent. For single-family units with no rental expectations this payment burden averaged 26 percent. The real obligation was undoubtedly higher since these figures do not include payments for taxes and insurance or utilities.

Were contract buyers aware of the differences between mortgage and contract financing? Did they inquire formally to a lending institution or informally to their broker about securing a mortgage? Did they seek legal advice for the transaction?

Although only ten percent of existing home buyers formally inquired about mortgage finance, this number does not present the complete story. Several buyers had previously tried to get a mortgage for a different property and were convinced from experience that blacks could not get mortgages. One buyer was told by his black lawyer: "They won't let you have a mortgage in this city. You got to have a third down, or some white man to stand up for you."[40] Most buyers who recognized the difference between a mortgage and a contract had consulted with the broker-seller about mortgage finance. Relying on the expertise of these specialists, they were dissuaded from directly seeking a mortgage loan from a lending institution. Those few buyers who formally pursued mortgage finance reported refusals by lending institutions to make loans in a particular neighborhood or for homes with excessive purchase prices. Other buyers had insufficient downpayments for a conventional mortgage. Regardless of buyer intent or action, however, the overriding factor was the refusal of speculators to sell a home except on contract.[41]

> I wasn't such a fool when I bought the house that I didn't have a mouthpiece with me.[42]

Recognizing their lack of experience and lack of sophistication in real estate transactions, the majority of buyers hired lawyers to allay doubts, fears and uncertainties prior to signing the contract

agreement.[43] Legal advice, however, was not particularly helpful. It rarely altered their resolve to buy or expanded their knowledge of contract buying. Some lawyers were either fradulent, working in cooperation with particular real estate agents, or professionally negligent for failing to inform the buyer of code violations and other property problems which might present obstacles to future obligations or a clear title.[44]

A second group of lawyers, by counseling clients that they were receiving fair treatment or that the price and contract terms were a "good deal", may not have been fradulent or negligent, but instead saw nothing inherently wrong with the contract transaction. If they considered whether blacks were experiencing discrimination in the housing market, it was within the traditional definition of differential seller pricing. Contract sales represented a "reality" of the black market which excluded consideration of institutional forms of discrimination.

A third, smaller group of lawyers did counsel buyers against the contract purchase because the price was too high. Buyers reported that many of these lawyers expressed concern with what was happening, but felt hopeless about changing the market situation. After "begging" clients not to buy, these lawyers could offer their clients no positive alternative. Also, frustration over housing accommodations and severe rental problems caused some buyers to filter out problems with the contract transation.

Prior to the CBL suits, there was one attempt by a lawyer to alter the situation facing contract buyers.[45] In behalf of two buyers,

he sued one of the largest south side contract sellers, claiming that the purchase price was improper because the seller had made false representations of the actual worth of the property. The Illinois Appellate Court refused the buyers any relief. By its action, the court reinforced existing professional beliefs about the "finality of signed contracts, doctrines of title, equity and possession, and the formidable requirements of showing fraud or any other ground" which would provide relief for buyers.[46]

The experience of contract buyers with legal services for contract transactions and redress of unconscionable terms exposed the limitations of individual suits as instruments for reform of the inequities of a dual housing market. Before the Contract Buyers League suits, litigation raised issues of individual wrong-doing and redress compatible with the traditional definition of discrimination. This was unsuitable for the contract buying issue because the forces behind contract buying were embedded in the nature of the marketplace, which was most eivdent when hundreds of such cases were exposed as a broad market phenomenon.

For many participants in the Contract Buyers League and subsequent litigation work, the central issue was not really the contract sellers' "ill-gotten" financial gains, but rather the question of power and dignity which was wrapped up in the seller-buyer relationship.[47] The dynamics of the CBL revealed the buyers' deep-seated sensitivities to racial exploitation -- their unequal bargaining position.[48] At the time of purchase, sellers were able to capitalize on buyers' predisposition to the values of homeownership and security

because of the latter's relative immobility and constrained housing choices. Sellers were able to effectively manage the buyers' view of facts, convincing dubious prospective buyers that buying was better than renting. If contract buyers were aware of a transaction markup, the extent of the markup was unknown -- comparable white market prices were not widely available to blacks. After the purchase agreement, buyers were bound in an unequal position by the finality of the contractual relationship; even the insurance benefits were in the name of the seller, despite payments made by the buyer. As time progressed, the disparate relationship worsened as the buyer's "equity" increased, the seller's risk decreased, and the seller's windfall profits, in the event of foreclosure, increased.

Contract Sellers

The real estate market is usually composed of three types of investors: non-professional investors (owners of single-family homes), professional real estate investors, and real estate speculators. In racial transitional areas, the speculator predominates.[49]

> A speculator is one whose motive in purchasing a property is to resell as soon as possible at a profit. He may or may not make repairs and may purchase on a contract for deed or he may buy outright.[50]

Objectively speaking, speculators are professional real estate investors who aim to buy low and resell at a higher price. However, in housing literature the word speculator has rarely connoted such a neutral image. Instead, it has most often been associated with unethical panic-peddling and blockbusting activities designed to rapidly initiate racial change and artificially reduce the price at which these operators purchase homes from fleeing white sellers.

Speculators in Chicago's contract market can be classified into two groups: real estate brokers and non-brokers in the market as principals. Some, but not all, speculators employed blockbusting tactics. In the words of one seller:

> I am a block-buster. Another and perhaps slightly less odious name for my craft is real estate speculator. I specialize in locating blocks which I consider ripe for racial change. Then I "bust" them by buying properties from the white owners and selling them to Negroes -- with the intent of breaking down the rest of the block for colored occupancy...I prefer blocks near others where Negroes already live -- especially old, middle-class blocks with a mixture of frame homes and walk-up apartments. Whites already there have been conditioned to insecurity by the inexorable march of the color line in their direction. This makes these blocks setups for the quick turnover, large volume and the large profits I like.[51]

In the dual housing market, the speculator operates in a realty vacuum created by institutional and economic relationships inhibiting direct real estate transfers between white and black households. As outside agents, speculators are not constrained to maintain an image in the white community, a professional and economic requirement which typcially hinders the early participation of local realtors in the transition process.[52] Mobility and lack of attachment to a small, defined neighborhood characterize the speculator's modus operandi. "They work an area that Negroes have entered until there is little left there to sell profitably and then move on to another area."[53] By providing a market for the purchase of properties owned by white households who choose to leave areas blacks may enter or are entering and then selling to the black, the speculator does "what other real estate agents do not want to do, or do not think they should do, or

will not admit they are doing -- act as the go-between for the white seller and the Negro buyer in an area still white or nearly so."[54]

In the installment contract market the speculator does more than arbitrage racial preferences in changing neighborhoods. He provides the financing to complete the transaction, to clear the market. For the white seller in a changing neighborhood, sale choices are limited. Because of institutional redlining, buyers in transitional neighborhoods cannot secure mortgage financing. An owner choosing to leave must often personally finance the transaction by taking back a purchase money mortgage or installment contract, or sell to a speculator for cash, typcially at a lower price than if he could have sold directly to the black buyer. From the owner's perspective, cash is an overriding factor because without the recapture of his equity, his next housing purchase is limited.

Contract financing of the black buyer is the other side of the market-clearing transaction. Because payment in a contract sale is amortized over the term of the contract, there is generally an upward adjustment to price. A major source of profit for the speculator arises from this disparity between the low _cash_ acquisition price in the _white_ market and a higher _contract_ selling price in the _black_ market.

Two conditions, therefore, immobilize conventional property transactions in racially changing neighborhoods: first, the racial preferences of white owners and local realtors, and second, the absence of mortgage finance. The speculator, acting as a broker and financial intermediary, arbitrages the profit opportunities existing from

discriminatory supply constraints on market activity. Given the lack of institutional mortgage money, the ability of the speculator to eliminate the first gap is a necessary but not sufficient condition for market clearing. Land installment contract sales insured market clearing by providing an instrument for both purchase and finance.

By arbitraging existing realty and finance constraints, the contract speculator considered himself an opportunist in a given market situation. By interposing his own credit rating between the black buyer and mortgage lender, he considered his activity a "beneficial" service which facilitated ownership transfer.

> They don't mention that...when it was almost impossible for a Negro to buy a house with F.H.A. or normal conventional mortgages, dealers sold houses to Negroes. These dealers invested their own money and pledged their own credit in order to make houses available to Negroes. They don't tell you that all new housing developments which were built in the past twenty years, were only built for white people...They don't tell you that the F.H.A. and the government itself turned its back on the problems of housing Negroes, and without the dealers, there would be no opportunity for decent families to own homes.[55]

The data from the Contract Buyers League litigation pertains exclusively to white speculators. Nevertheless, black real estate brokers were not absent from this market. Additional CBL evidence did reveal the existence of a number of black speculators and trial testimony brought to light the financial details of one contract sale by a black professional appraiser which were strikingly similar to those of white contract sellers.[56]

Selling homes on contract did not release the speculator from conventional management concerns or tenant-landlord relationships.

It did eliminate rental maintenance responsibilities and shift the liability for real estate taxes, insurance and code compliance. Nevertheless, monthly payments had to be collected, delinquencies monitored, taxes and insurance paid and, as these contract neighborhoods aged, the potential for vandalism in vacant buildings checked. Why then did these speculators "sell" as opposed to "rent"? What additional benefits flowed from this form of property management?

The dual housing market created a situation of pent-up demand for housing. Coupled with a block-by-block, or "cave-in" expansion policy, the initial period of transition presented the only opportunity to earn "turnover" profits for the recently available housing as blacks sought to satisfy preferences for relatively better housing services available in the transition areas. The installment contract sale yielded greater long-term profits than a rental because it offered a means of locking in the initial price surges associated with limited, block-by-block ghetto expansion. In an internally competitive black market, over time as the geographic boundaries of the area expanded and new neighborhoods became available to black occupancy, rental payments in the earlier transitional neighborhoods would decline to reflect increased supply and an easing of the housing shortage. In contrast, the contract price and monthly payments, fixed at the time of purchase, would lock in for the term of the contract the high prices associated with ghetto expansion. With an installment sale, the seller also stood to benefit from "owner psychology" toward property maintenance.

Sources of Profit

Table 2-7 presents a breakdown of the components of a typical contract transaction for an existing two-flat building on Chicago's west side during the height of installment sales activity. The property was acquired for $14,200 and sold for $26,000 within three weeks of the purchase. To maximize his return, the speculator financed the property with a mortgage loan of $15,000 for 20 years at seven percent. After adjustments for acquisition, financing, repairs and renovation, estimated holding and selling costs, the deferred profit was $9,546, a 67 percent net markup. This would represent a very large return on the $204 investment. This is the dramatic contract sale paper profit commonly cited in housing literature.

To realize these profits the speculator has two main options: hold the contract until term or cash out his property interest. In the first case, the cash profit accrues from the annual gross cash flow received by the seller; this is the difference between the annual contract payments and the annual mortgage payments, in this example, $708 (a 347 percent per annum rate of return). The present value of this difference between loan payments made by the buyer to the seller and those made by the seller to the lending institution, less an allowance for administering the loan and any initial equity, represents the seller's long-term net profit assuming that the contract is not forfeited. In this example, using the seven percent mortgage interest rate as the discount rate, the present value net profit equals $8,502. Given the higher risks in this sector of the market, this rate is unrealistically low; the cost of funds for some speculators in this

TABLE 2-7

Installment Contract Transaction for an Existing West Side Two-Flat Building, 1960

Sold to black buyer	$26,000	
Cost to speculator	14,200	
Gross Markup	11,800	83.1%
Costs to Speculator		
Acquisition price	$14,200	
Title and associated costs	185	
Repairs/renovation	12	
Estimated:		
Sales commission	1,300	
Carrying costs during selling period	0	
Overhead during selling period	7	
Financing costs	750	
Total Costs	$16,454	
Deferred Profit	9,546	67.2%
Cash Flow at Contract Sale Closing		
Total Cash In		
Contract downpayment	$ 1,250	
Mortgage proceeds	15,000	
	$16,250	(a)
Total Cash Out		
Direct costs	16,447	
Indirect costs (overhead)	7	
	$16,454	(b)
Equity (b - a)	204	(c)
Annual Cash Flow Analysis		
Annual loan payments by the buyer to the speculator ($24,750 loan for 25 years at 7%)	$ 2,100	(d)
Annual loan payments by the speculator to the mortgage lender ($15,000 loan for 20 years at 7%)	1,392	(e)
Estimated cost of administering the contract (5% of contract payment)	105	(f)
Net cash proceeds per year, year 1 through 20 (d - e - f)	603	(g)
Net cash proceeds per year, year 20 through 25 (d - f)	1,995	(h)

TABLE 2-7, continued

Net cash proceeds over the term of the contract [(g x 20) + (h x 5)]	$22,035	
Present value of $603 annual income stream received over 20 year period assuming a 7% discount rate	6,388	(i)
Present value of $1995 annual income stream received over 5 year period after 20 years assuming a 7% discount rate	2,114	(j)
Total present value of contract sale payment stream received over 25 year period assuming 7% discount rate (i + j)	8,502	(k)
Total present value of contract sale payment stream received over 25 year period assuming 15% discount rate	4,183	(l)
Present value net profit at 7% discount rate (k - c)	8,298	
Present value net profit at 15% discount rate (l - c)	3,979	
Timelag between acquisition and resale (days)	20	

market greatly exceeded prevailing conventional mortgage rates. Using a 15 percent discount rate, the present value net profit equals $3,979.[57]

If full cash payment were received at the time of sale, a speculator might be willing to accept a price of $19,683 or thereabouts ($15,704 + $3,979), representing a 25 percent profit on the transaction.[58] This is a hypothetical "cash" price because it would undoubtedly exceed the mortgage appraisal figure. The argument against installment contract sales rests on this type of selling-finance distortion: speculators used installment sales as a means to capture excessive profits based on inflated sales prices which could not have been supported by institutional mortgage finance. The difference between this "cash" price and the contract price measures the extra component of the black market price required to transfer units to the black market through the contract sale mechanism.

The second way a speculator realizes the deferred profit is to cash out his interest prior to contract maturity by selling the contract paper at a deep discount, usually 40 - 50 percent, to an investment group which specializes in purchasing and managing contract paper (Table 2-8). These investment groups represent the small secondary market of contract financing. Alternatively, the seller could cash out by obtaining a conventional or FHA mortgage for the contract buyer (Table 2-9). Cashing out of the investment was used by only a handful of sellers in the west side submarket and was based on individual business requirements.[59] The evidence suggests that sellers utilized cashing out as a means of securing revenues to

TABLE 2-8

Profit Analysis of Investment Cash Out Through Sale of Contract Paper, 1963

Contract balance at time of paper sale	$20,116	
Mortgage balance at time of paper sale	7,090	
Book value equity	13,026	
Purchase price of book value equity at 60% discount	$ 5,210	
Cash Flow Proceeds of Contract Sale Prior to Paper Sale		
Annual payments by buyer to seller	$ 1,980	
Annual payments by seller to mortgage lender	1,260	
Estimated cost of administering the contract (5% of contract payment)	99	
Annual net cash proceeds	621	
Net cash proceeds over 2.75 years of contract payment prior to paper sale	1,708	
Present value of net cash proceeds from holding contract over 2.75 years assuming a 15% discount rate	1,321	(a)
Present value of net cash proceeds from sale of contract paper after 2.75 years assuming a 15% discount rate	3,547	(b)
Present value of total net cash proceeds of contract transaction (a + b)	4,869	(c)
Seller's Cash Flow at Contract Sale Closing		
Total Cash In		
Contract downpayment	$ 1,000	
Mortgage proceeds	9,000	
	10,000	(d)
Total Cash Out		
Direct costs	12,803	
Indirect costs	19	
	12,822	(e)
Equity (e - d)	2,822	(f)
Present value net profit (c - f)	2,047	

TABLE 2-9

Profit Analysis of Investment Cash-Out Through FHA Refinancing for Contract Buyer, 1969

Amount of FHA mortgage	$16,800	
Outstanding contract balance at time of FHA refinancing	16,883	
Contract price reduction	83	
Seller's Obligations in FHA Refinancing		
Discount points	$ 1,512	(9%)
Discharge of conventional mortgage	9,119	
Other	1,673	
Total	$12,304	
Net proceeds to seller from FHA refinancing	$ 4,496	
Cash Flow Proceeds from Contract Prior to FHA refinancing		
Annual payments by buyer to seller	$ 1,944	
Annual payments by seller to mortgage lender	1,404	
Estimated cost of administering contract (5% of contract payments)	97	
Annual net cash proceeds	443	
Net cash proceeds over 6 years	2,658	
Present value of net cash proceeds from holding contract 6 years prior to FHA refinancing assuming a 15% discount rate	1,677	(a)
Present value of net cash proceeds from FHA refinancing after 6 years of contract payment assuming a 15% discount rate	1,944	(b)
Present value of total cash proceeds of contract transaction (a + b)	3,621	(c)
Seller's Cash Flow at Contract Sale Closing		
Total Cash In		
Contract downpayment	$ 350	
Mortgage proceeds	13,000	
	13,350	(d)
Total Cash Out		
Direct costs	14,393	
Indirect costs (overhead)	2	
	14,395	(e)
Equity (e - d)	1,045	(f)
Present value net profits (c - f)	$ 2,576	

purchase additional properties, to liquidate the business, or to eliminate strained relations with contract buyers.[60]

What are the comparative profits of these alternative strategies? Table 2-10 presents the average present value net profit figures for each option.

TABLE 2-10

Present Value Net Profits for Alternative Management Options

Option	Average Present Value Net Profit *	Equity	N
Holding contract until term, no forfeiture	$2,667	$1,350	290
Cashing out to investment syndicate mortgage co.	2,045	1,751	7 **
Cashing out with FHA refinancing for contract buyer	2,865	945	7 **

* Assuming a 15 percent discount rate.
** Small sample due to limited data availability.

If the seller held the contract until term he could expect a present value average net profit of $2,667 compared to $2,045 for cashing out through sale of the contract paper and $2,865 for FHA refinancing. While FHA refinancing provided the highest present value profit, this alternative was not available before 1966.[61]

The federal tax treatment of installment sales provided the seller with additional transaction benefits. Through either the cost recovery method or the installment sales method, a seller could defer all or part of the capital gains tax liability from the transaction.

In the former instance, the capital gain was not subject to taxation until such time as all costs incurred in the transaction had been recovered. For two large speculators who exclusively used this method, the period of complete tax-free cash flow averaged seven years. For those speculators utilizing the installment sales method, the federal tax liability was spread over the term of the contract and paid in proportion to the receipt of payments for contract principal. If there had been a $5,000 capital gain on a property with a $15,000 contract price, the capital gain tax liability in each year would have equaled one-third of each dollar of principal payment.[62]

A strategy of strict enforcement of contract delinquency and resale provided another source of profit for the speculator. When the contract buyer forfeited his contract, the seller was legally entitled to evict the buyer, repossess the property and retain prior payments as liquidated damages.

> Some indication of the extent of this practice can be gained from two independent and related sources. Inspection of the advertising columns of the leading weekly Negro newspaper show two and three columns of homes and apartment buildings offered at five hundred to nine hundred dollars down, with never a mention of total price or monthly payment, all advertised by one owner. An examination of the titles of forcible entry and detainer suits filed in the Municipal Court of Chicago, seeking possession of the "entire premises," and filed in the name of the same advertiser, runs for the period from January 1956 to October 1957, to two hundred eighteen cases.[63]

Although less widespread, other sources of profit included mortgage refinancing and returns from other components of the transaction. Many sellers were lawyers or real estate brokers who functioned, either individually or corporately, in more than one capacity and

earned fees for legal services, brokerage and management.

THE ECONOMIC STRUCTURE OF THE INSTALLMENT CONTRACT MARKET

Participants and Market Shares

The market of contract sales existed primarily in areas of ghetto expansion, in those neighborhoods of existing housing where block-busting and panic peddling activities most often accompanied racial transition. Often completed within three to five years, racial change in these neighborhoods conformed to a pattern of rapid mass invasion,[64] an effect significantly reminiscent of the block-by-block expansion policy first endorsed by the Chicago Real Estate Board in 1917.

This similarity is paradoxical because speculators and realtors hold opposite racial ideologies and speculators operate outside the professional code of realty ethics. While the realtor has an economic incentive to prevent nonwhite entry into white neighborhoods, the speculator's incentive is to control the number of neighborhoods undergoing racial transition.

High profits for speculators in the dual market are a function of the rate of expansion and whether infiltration and consolidation occur before more expansion. Nevertheless, the ability to control the geographic scale and the rate of ghetto expansion implies market power on the part of individual speculators or collusion, both generally considered improbable in real estate markets. Did such market power exist in the installment contract market?

Requiring more knowledge than capital, presenting few formal barriers to entry and yielding large profits, contract selling attracted numerous participants. The original 1969 complaint for Contract Buyers League v. F & F Investment presents a lower bound estimate of the number of sellers; it listed 91 defendants operating in the Chicago installment contract market between 1952 and 1968. By 1975, the number of defendants totaled 102. After adjusting for multiple business identities of several sellers, there were 41 known operators. Trial motions reduced the analysis sample to 32 contract operators.[65]

Classifying these contract operators by their sale volume presents a better picture of their position in the market. Nine defendants, holding 6 percent of the universe properties, did not originate contract sales (contract assignees) but acquired title ownership of the property either by legal assignment through purchase of the paper (7 defendants) or through mortgage foreclosure proceedings (2 defendants). In contrast, 94 percent of the properties were held by the remaining 23 defendants who originated contract sales.[66] Ten speculators, each with more than 100 contracts, accounted for slightly over 75 percent of the universe properties (Table 2-11).

Despite numerous sellers, the structure of this portion of the market displayed considerable concentration of sales by large-scale sellers. The largest five speculators on the west side and the largest three on the south side, respectively, controlled 64 percent and 76 percent of the prime contract sales -- those properties in the neighborhoods of early transition;[67] fifteen speculators accounted for the

residual sales. As shown in Table 2-12, individual shares varied considerably. The largest share of the universe sales, held by Boston,[68] exceeded 32 percent between 1950-1960; the second-largest speculator accounted for 19 percent of these sales. The smallest share among the large-scale speculators equaled 5 percent of the sample subset.

TABLE 2-11

Distribution of "Universe" Installment Contract Properties by Type of Market Investor and Scale of Sales Volume, 1952-1968

Type of Investor	Number of Properties in Universe		Percent	
Contract Originators				
Large-scale (≥ 100 properties)	1,944		75.2	
Small-scale (< 100 properties)	477		18.5	
Subtotal		2,421		93.7
Contract Assignees	165		6.3	
TOTAL	2,586		100.0	

In the west side market such extreme market concentration did not persist over time as new speculators entered the field. The death of Boston in 1963 and competition from numerous small speculators succeeded in leveling individual sales shares and reducing the total share of the largest five to 50 percent for the 1960-1970 period, compared to 70 percent for 1950-1960.

The pattern of south side activity differed. With few new speculators entering and the shares of small-scale speculators remaining constant, a reduction in individual sales shares resulted from

TABLE 2-12

Contract Sales Shares Among Large-Scale Originators for Universe Properties in Early Transition Neighborhoods, 1950 - 1970

Contract Originator	Distribution of Universe Properties in Early Transition Neighborhoods*					
	1950-1960		1960-1970^{+}		Total	
	Number	Percent	Number	Percent	Number	Precent
I. West Side						
Boston	369	32.5	32	6.8	401	24.9
Hicks	213	18.7	44	9.3	257	16.0
Cone	83	7.3	75	15.9	158	9.8
Mills	56	4.9	62	13.2	118	7.4
Stern	70	6.2	24	5.1	94	5.9
Subtotal	791	69.6	237	50.3	1028	64.0
Others	346	30.4	234	49.7	580	36.0
TOTAL A	1137	100.0	471	100.0	1608	100.0
II. South Side						
Peck	175	43.2	26	21.1	201	38.1
Master	95	23.5	23	18.7	118	22.3
Church	41	10.1	43	35.0	84	15.9
Subtotal	311	76.8	92	74.8	403	76.3
Others	94	23.2	31	25.2	125	23.7
TOTAL B	405	100.0	123	100.0	528	100.0
TOTAL A + B	1542	72.2	594	27.8	2136	100.0

* Early transition neighborhoods = Penetration, Invasion and Early Consolidation stages; for definitions, see Table 2-1.

+ Most sales between 1960 - 1965.

the entrance of one speculator and the growth of his business. Between 1960-1970, the largest two originators controlled approximately 40 percent of the contract universe sales, compared to 67 percent between 1950-1960. Nevertheless, the combined sales volume of the three largest originators dominated the south side market.

Although spatial expansion of the ghetto between 1960-1970 provided continuous sales opportunities, after 1965 the incidence of contract sales declined due to external influences on the contract market. Consequently, the 1960-1970 period reveals more speculators competing for smaller number of sales in both sectors.

Geographic Concentrations

It is important to know if the aggregate figures conceal variations within the west and south side submarkets. Did speculators concentrate activity in any community? There was no apparent division of territory on the large spatial scale of community areas because the block-by-block character of racial transition inhibited such patterning. Furthermore, the distribution of property in a speculator's portfolio reflected his tenure in the contract market. Those west side originators entering the market earliest had higher proportions of properties in North Lawndale and East Garfield Park than those entering the market after transition activity had shifted to West Garfield Park. More than half of the speculators concentrated their activities in West Garfield Park simply because it was the focal point of racial transition on the west side during the peak of the market.

Table 2-13 clearly reveals the consistent dominant sales position of the four largest speculators across community areas. (Boston's

TABLE 2-13

Percent Distribution of Existing Home Contract Sales by Speculator by Community Area, 1952 - 1968

West Side Community Area	Large Scale Contract Originator						
	Boston	Hicks	Cone	Stern	Mills	Others	Total
North Lawndale n = 372	31.2	10.2	7.5	14.8	6.2	30.1	100.0
East Garfield Park n = 508	35.6	22.0	4.3	2.2	3.2	32.7	100.0
West Garfield Park n = 757	16.6	14.5	13.6	6.3	10.4	38.4	100.0
Total n = 1637	25.8	15.9	9.3	7.0	7.2	34.8	100.0

South Side Community Area	Peck	Master	Church	Others	Total
Englewood n = 331	38.4	26.9	14.5	20.2	100.0
Greater Grand Crossing n = 105	44.8	32.4	4.8	18.0	100.0
West Englewood n = 87	31.0	16.1	41.4	11.5	100.0
Total n = 523	38.4	26.2	17.0	18.4	100.0

relatively small share in West Garfield Park can be partially attributed to his death and sudden curtailment of business.) With only two exceptions, Boston and Hicks and Peck and Master held dominant positions in each community area within their respective markets.[69]

The community designations used so far are large spatial and population groupings with historical and modern significance for urban sociological identity, but their size exceeds a personal notion of a neighborhood. Did the largest speculators account for major sales activity in neighborhood census tracts? Yes. The distribution of indivdiual sales shares at the census tract level does not reveal territorial divisions but reinforces the joint dominance of the largest sellers.

Orthodox economic models of urban housing markets present blockbusting and speculative real estate transfers as a competitive, privately initiated response to market imperfections which inhibit direct transfers between white and black households, one which will eliminate any excess profits. Yet the evidence from contract sales shows that while numerous speculators participated in the market, the observed structure more closely resembled an oligopolistic market.

The evidence also shows that contract originators concentrated their activities in large geographic sectors -- in either the west or south sides of Chicago. Only four contract originators operated in both submarkets. In contrast, the common practice among contract assignees was to participate in both geographic submarkets. This pattern is understandable. Real estate sales origination commonly represents an investment in knowledge, expertise, about the local

market conditions. In contrast, secondary real estate transactions reflect the contract assignee's expertise in evaluating the financial characteristics of the contract paper sale. Similar to the operations of the conventional secondary mortgage market, the common characteristic of those contracts held by assignees would be the nature of the risk of the underlying collateral and the borrower, rather than just the specific property location.

Cooperative Relationships Among Contract Sellers

Up to now the discussion has focused upon formal sales shares over time, and as a proxy for activity at a single point in time, upon geographic submarkets. Yet the line between formal sales power and patterns of informal cooperation significantly colored the choices, prices, and terms facing contract buyers. The CBL complaint defined "unlawful combination and conspiracy in restraint of trade and commerce" in the purchase and sale of real estate properties and in the discounting of installment contract paper as consisting of "a continuing agreement, understanding and concert of action among defendants and other co-conspirator purchasers, sellers and financiers of real estate properties to fix, maintain and stabilize prices on the sale of properties to plaintiffs at approximately $5,000 to $15,000 per unit above the fair market value,"[70] and having the effect of eliminating price competition among speculators and associates.

While it cannot be shown that all speculators met together conspiratorially in some board room or lavatory for the purpose of price-fixing or dividing up territories, evidence does indicate that

most speculators entered into various types of relationships with each other.[71] In their complex maze of relationships (Figure 2-2) some speculators:

(1) established general partnerships for periods of time;

(2) established partnerships for individual properties by holding beneficial interest in certain land trusts with other speculators;

(3) acted as brokers for white owners in the sale of property to other speculators;

(4) assigned beneficial interest in certain land trusts to other speculators;

(5) employed or otherwise did business with the same companies, agencies or individuals as other speculators for services such as mortgage finance, brokerage, insurance, legal advice, and labor or materials for improvement.

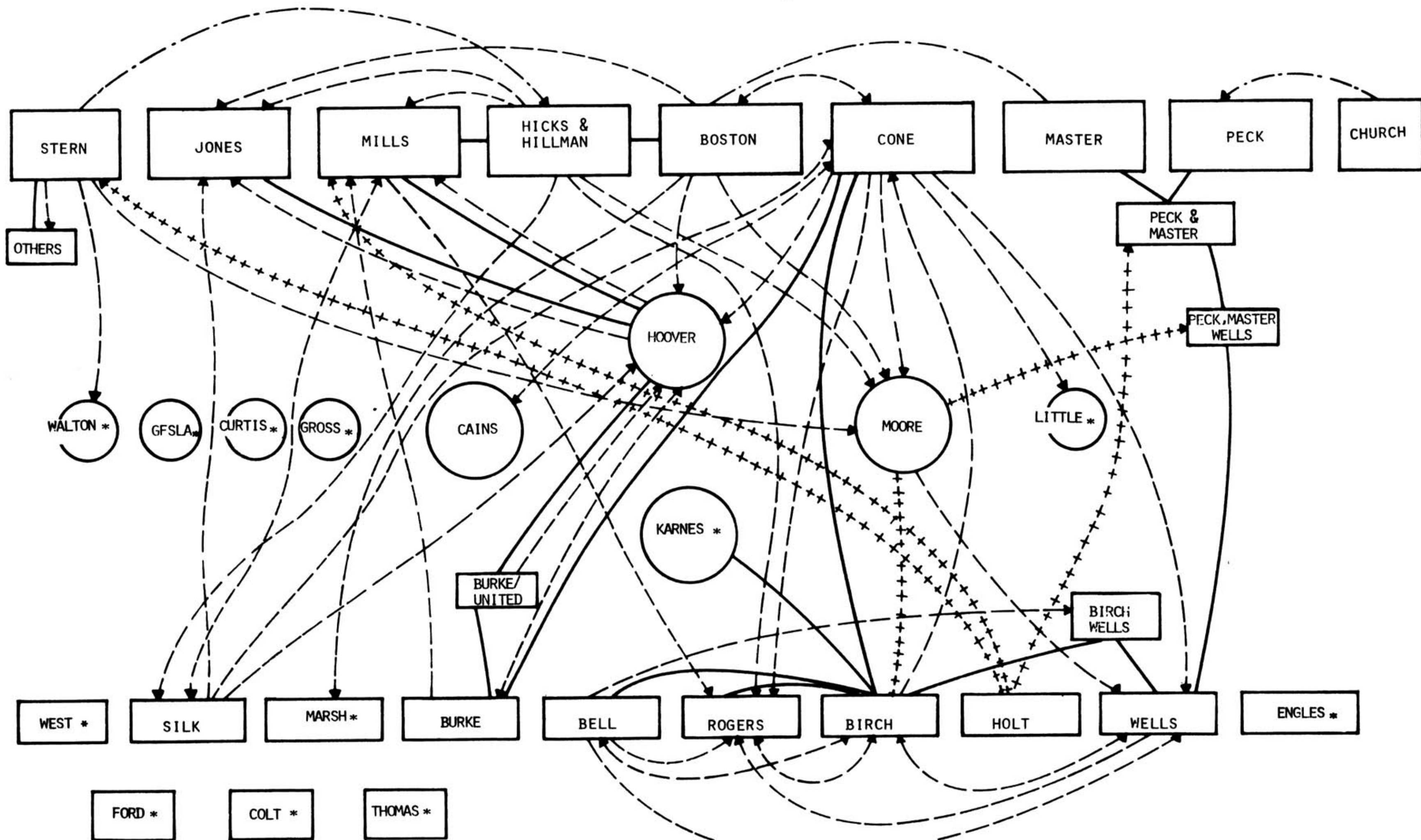
In addition, the names of certain corporations and individuals appeared in connection with more than one speculator, implying that some speculators had mutual associates.

The degree of cooperation and personal familiarity involved in these multiple arrangements clearly varied. In the first two instances, interests of mutual benefit prevailed over competitive roles. The fourth and fifth associations, while profitable for both parties, represented exchange relationships which took place after the contract transaction and which would not have inhibited a prior competitive relationship.

General partnerships provided less maneuverability than joint venture agreements for individual properties. In fact, such partnerships were operative only before peak market activity. Despite Hicks' partnership with Hillman, between 1959 and 1964, he continued

FIGURE 2-2

Relationships Among Contract Operators



KEY:

* No data available for this operation

—— Joint trust beneficiaries

- - - Assigned interest in property (sale of contract paper)

- - -➔ Direction of assignment

++++ Brokerage arrangement

-·— Other

NOTES:

The names listed above often represent more than one business identity.

The relationships shown do not exclude the possibility of other associations.

Many of the speculators had other joint trust beneficiaries who were not party to the law suit.

Several of these operators were associated indirectly through mutual joint trust beneficiaries.

to operate independently on many properties. His subsequent partnership with Mills only lasted six months. The eleven-year general partnership between Peck and Master ended in 1957, the year south side market accelerated. Even so, Peck and Master retained the same office space for more than one year after the formal split.[72]

This pattern of partnerships and joint ventures among competitors significantly alters the conventional image of competitive speculative relations. As shown in Figure 2-2, all speculators were involved in some form of interrelationship. The four major alliances -- Hicks with Hillman, later with Mills; Peck with Master; Birch with numerous others; and the Hoover et al. complex web of associations -- are notable for the interrelationships among major market powers and the multiple types of business relations between the same pair of speculators. It was not uncommon for speculators to be co-beneficiaries in one transaction, yet buyer and seller in the exchange of contract paper in another. Familial relationships between a few business entities further clouded competitive relationships.

More informal than co-beneficiary relations, but more extensive, relations for the purchase and sale of contract paper drew the participation of all speculators. Properties were transfered with anonymity and without the expense and time of title transfers, and hence recording, by assigning over 100 percent interest in the trust which held title to the property. The source of profit from these paper sales provided a cooperative incentive to maintain inflated contract prices. It was the large gap between purchase and sale prices which made it possible for speculators to generate cash profits despite a 50 or 60

percent discount of paper equity. If a speculator expected to sell paper at a discount yet still net out a certain return, the markup could easily be adjusted to yield the desired gross profit after discounting.[73]

The existence of numerous speculators engaged in a pattern of complex, interlocking associations raises several issues. What were the costs of gaining additional market shares versus the benefits from cooperation? Did speculators seek to increase their market shares through price competition if excess demand guaranteed them above normal profits anyway? If profits were so high, why weren't there more participants?

Given the relatively small geographic area of each submarket, the cost of gaining additional market control may have exceeded the benefits from cooperation. The extensive relationships among speculators suggest that this was a realistic trade-off. Aside from the obvious benefits of split profits derived from partnerships, cooperative relations would maintain the inflated price structure and stimulate the sale of related services offered by speculators in other capacities such as brokerage, insurance, legal advice, mortgage finance, property management. A speculator's ability to increase his share of the market depended upon other components of the supply equation, an additional supply of property and capital, as much as upon securing additional contract buyers through price competition.

If mutual understanding of market incentives and beneficial arrangements inhibited contract sales price competition, it did not preclude other forms of competitive behavior.[74] After successfully

negotiating the purchase and sale of a west side property, Boston wrote his frequent associate:

> [Hicks] must be burning on this one. The seller showed me [Hicks'] unsigned contract for the purchase dated January 11, 1957 for $7,700. He could not close the man.[75]

Boston paid the white-resident seller $7,500 a month and a half later. This same speculator offered "rewards" of $100 or an equivalent downpayment credit to contract buyers for leads that resulted in a purchase of a property.[76]

Collusive agreements have always been difficult to arrange and enforce in a market of many participants. But such agreements need not be formal, nor restricted to price setting or territorial shares. The market may engender informal mechanisms of cooperation that preserve a competitive incentive but funnel it into other forms of competition while preserving the inflated price structure of the installment sale. This does not imply that sellers do not compete against one another for acquisitions.[77] Nor does it mean that profits do not vary among speculators due to differential costs of other inputs such as finance and management services.

Specialized Knowledge and Barriers to Entry

The economic laws of supply and demand state that over time competitive forces direct a market toward self-correction. High profits attracting additional participants beat down high prices and erode excess profits as speculators compete against one another for a larger share of the market. There are several factors which affect the ability of the contract market to self-correct.

Both white prejudice and excess demand among blacks for "decent" housing shape the market incentives for arbitrage. The self-correcting argument assumes that the net effect of speculative activities offsets demand. However, to the extent that sellers are able to capitalize on white fears of racial change (declining property values, crime, overcrowding in schools), secure particular types of housing in short supply (homeownership units), or control the pace of transition, they may still be able to purchase at a depressed price or exact a sale premimum.

The competitive market argument further assumes public knowledge of the level of profits and no significant barriers to entry into the market. In the contract market information on the high profit levels remained private; these were non-public businesses in small, local markets. Technically speaking, entry into the contract market was free, no licensing requirements governed entrance as a seller. There were no real economies of scale to inhibit entry either. But there was a substantial capital requirement for full-time operators -- speculative installment sales required a continuous supply of capital, otherwise business was limited by the personal distribution of wealth and the possibilities of using partnerships. As will be shown in the next chapter, the availability of capital in the contract market affected business volume. Furthermore, speculative activities required specialized knowledge regarding the neighborhoods most susceptible to change, the business and legal procedures of contract selling, and the institutions, individuals and mortgage companies willing to write mortgages to finance contract selling. In this type of environment

information became a commodity and its owners possessed a degree of monopoly power.

Barriers to entry and information are critical factors explaining the development and persistence of the dual housing market and in the particular instance, the installment sales market. For the buyer it is the barrier to entry into the metropolitan white housing market, or inversely, the limited exit from the ghetto into selected transition neighborhoods. The buyer rarely has information on the price and bundle characteristics of housing in white neighborhoods; when he shops, he shops the black market. For the seller, entry and business expansion depend upon capital leverage. The next chapter focuses on these institutional parameters of the contract market.

CHAPTER 3

The Role of Financial Institutions in the Installment Contract Market

The Chicago gentlemen's agreement is well known, freely admitted, but so far as we know, it is not an official document available to us to present to you. In essence it is an understanding that no real estate dealer will sell or rent to a nonwhite in any block, until the block has been "cracked" by the presence of a Negro family there by some other means. The real estate dealer who violates this agreement is punished severely by the industry. He finds his financial services leave him, and he may be driven out of business in short by what follows.

U.S. Commission on Civil Rights, Hearings, Chicago, 1959.

The market of installment sales -- that "other" means -- developed in response to a supply vacuum created by a set of private and public institutional practices commonly referred to as The Gentlemen's Agreement. Codified into the realtor's professional norms and technically legitimized in underwriting theories linking neighborhood homogeneity with the stability of property values, institutional support for residential racial segregation fostered a self-perpetuating mode of discrimination. These institutional norms inhibited direct mobility between white and black housing markets. "No Negro" or "no integrated area" institutional practices maintained the color line by restricting lending or brokerage activities to established segregated neighborhoods, thereby creating the market context for contract sales by channeling unfulfilled black demand to the ghetto real estate professionals managing racial transition.

While formal sanctions at one time influenced compliance with segregationist norms, economic incentives related to long-term profit opportunities in both the real estate and financial communities continued to foster institutional discriminatory behavior.[1] The cumulative effect upon the structure of urban housing markets of incremental de-

cisions made by numerous participants, who shared a racial ideology and common professional indoctrination in real estate appraisal, was much the same as if there had been explicit collusion: blacks lacked direct access to the larger white housing market.

Numerous financial institutions in Chicago engaged in two types of behavior that directly affected the market environment and profitability of contract selling: (1) they employed underwriting policies derived from racially biased economic theories which had the effect of denying blacks direct access to the white housing supply, and (2) they directly aided and abetted the contract finance system by bankrolling speculative transactions with mortgage loans secured by contract properties.[2]

This chapter begins with a review of the institutional policies that created the financing vacuum in racially transitional neighborhoods and goes on to address the major issue of institutional involvement -- the seemingly contradictory decision of many institutions to underwrite speculative mortgage loans in transitional neighborhoods, the antithesis of "good" lending behavior. If institutional lenders declined to grant mortgage loans in transitional neighborhoods because of the uncertain effects of racial change on property values, how then did speculators in the existing home contract market finance their operations in these neighborhoods, and at that minimize their cash investment? Which institutions and individuals extended credit in this risky market? What were the costs and benefits for the institution from this involvement?

INSTITUTIONAL DISCRIMINATION: "NO INTEGRATION" POLICY

> Chicago area real estate brokers and mortgage lenders who deal with nonwhites have told the Commission that mortgage funds are available to qualified Negro home buyers in all-Negro communities, such as Park Manor and Chatham, and in once-all-white areas where Negroes are now purchasing and occupying homes. These brokers complain, however, that it is difficult to obtain a mortgage in certain older neighborhoods. These very complaints, though, illustrate the striking change that has occurred during the past several years in mortgage availability for nonwhites. In 1950, brokers' complaints would center around the problem of simply obtaining a mortgage for nonwhites anywhere, any place. Today's complaints center around getting a mortgage for a particular house in a particular neighborhood... Few financial institutions will process loans for nonwhite borrowers wishing to purchase in all-white neighborhoods in the city or suburbs.[3]

Despite the sanguine tone of the report of the Chicago Commission on Human Relations describing the progress of a decade toward easing the shortage of mortgage funds for blacks, there was still widespread refusal to lend for black entry into a white neighborhood or one in the early stages of transition. It was no secret that mortgage money was not available to black or white purchasers in "threatened" neighborhoods.[4] The lending industry,[5] acting on the premise that only homogeneous neighborhoods could offer an economically sound investment, in effect tacitly agreed to restrict black mortgage financing at the point of racial change and lend, if at all, only in established Negro communities.[6]

This geographic status quo lending policy was a constraint on the supply adjustment process of the black housing market. Transition neighborhoods have historically played a significant role in the incremental expansion of the black housing stock. The existing ghetto housing stock, often unsuitable for the conversions, mergers or up-

grading required by changes in housing demand, nevertheless most often lacked neighborhood amenities and public services available in housing bundles in other locations. Regardless of a desire to live in an integrated neighborhood, increases in black housing demand exerted pressure on existing white neighborhoods, since newly constructed private units provided a relatively insignificant share of stock additions, particularly in the black sector.[7]

The "no integration" policy ostensibly derived from lenders' major concern with equity recovery and the investment risks attendant upon the neighborhood change which inevitably followed the introduction of a black into a white neighborhood. Historically, in periods of little new housing expansion in the white market, violence and property damage often accompanied the initial sales threatening racial change.[8] Lenders also habitually cited the instability of prices in rapidly changing neighborhoods where "price" and "value" were not the same.

The economic incentives for lending institutions to restrict the geographic locations of mortgages granted to blacks is further explained in terms of the institution's market position and public profile. By lending to a black family in an all-white neighborhood in which the institution had already made mortgage loans, it would be "spoiling" its own market by introducing instability -- when stability is one of its primary concerns in loan origination. Lending institutions, therefore, view such lending as undermining their outstanding portfolio of loans, despite the fact that there is considerable evidence that the movement of blacks into white areas does not, in the long run depress property values.[9] As holders of mortgages of whites who may

all seek to leave at once, there may be short-term price changes that could leave the institution in a vulnerable position, depending upon the the relationship between the outstanding mortgage balances and the transitional market prices.

Lending institutions' reluctance to lend in all-white neighborhoods equally derives from a concern with the potential resentment of white depositors.

> We take the position that the first two or three sales to Negroes in any block should be financed between the parties ...There are five savers in every block in Chicago.[10]

> We do not finance the first Negro purchaser in white area for public relations reasons. White resentment in the area would be great, probably resulting in account cancellations and discontinuance of other business.[11]

The public relations motive, however, does not exert a uniform force in all areas or upon all lenders; there is room for differing judgements about the effects of lending policy, which produces a vague and variable stance regarding the acceptable timing of such lending.

> The long standing unwritten policy of mortgage men not to finance the Negro unless his is the fifth house to go black in a white block, is currently being adjusted to the third or even the second house.[12]

> [We] do not insist that neighborhoods be 50 percent colored, or insist on any arbitrary statistical line before lending to Negro applicants. Depends on circumstances.[13]

"Non-deteriorating areas" has often been the qualifier -- the missing economic element put forth by lenders to explain the lack of observed equal lending treatment. Industry spokesmen persist in viewing the finance problem as a problem of inferior ghetto property, citing public interest as the reason not to finance properties where "building codes,

zoning and other city ordinances are violated."[14] Chicago's leading black mortgage lender notes:

> Economic factors, hell. Look at all those Polish neighborhoods along the Dan Ryan. They're ready for urban renewal. But the money pours in. Or look at the Back of the Yards. That's an old area. But then look at Douglas Park, or Garfield Park. If they had the flow of mortgage money they wouldn't be gutted as they are today. When these neighborhoods changed there was money available all right, but to speculators who milked the persons who wanted homes there...The house represents a method of capital appreciation in the ghetto community. And a strong capital base is a threat to the white community.[15]

The absence of institutional financing in the black housing market during the period of contract sales cannot be solely ascribed to racial discrimination. Poorly maintained housing and less qualified buyers do increase the risk of mortgage lending, and both occurred more frequently in the black market. The major issue in any analysis of geographic allocation of residential finance has always been to separate race from economics. Yet early underwriting theories, clearly derived from racially affected economic theories, and subsequent credit denial, contain the seeds of a self-fulfilling prophesy regarding neighborhood conditions. The unacceptability of much nonwhite property for FHA-insured or conventional loans is symptomatic of the larger problem of restricted access of nonwhites to real estate in areas which would meet lending standards.

Liability of the Federal Housing Administration

The overriding concern of the lending industry with the neighborhood homogeneity criterion can be traced to the Federal Housing Administration's systematic development and active promotion of the

neighborhood unit and the race restrictive covenant as reference standards for loan evaluation. The FHA standards and locally defined lending areas often established the norm for conventional lenders. FHA began its career by accepting the prevailing real estate ideology that blacks should be denied access to white neighborhoods in order to protect property values in those neighborhoods. While FHA did not invent the restrictive covenant nor the ideology behind it, its adoption conferred official sanction upon it and stimulated its widespread usage.[16]

The CBL complaint against the FHA, incorporated in Baker v. F & F Investment, stated that FHA's promotion of racially restrictive covenants and racially determined underwriting theories contributed greatly to residential segregation in Chicago with the consequent narrowing of choice and limiting of mortgage financing available to blacks. The detailed evidence against the federal agency,[17] paralleling that found in numerous accounts,[18] supported two related claims: (1) the FHA developed and supported discriminatory underwriting policies based on a perception of how race affects property values and (2) the FHA maintained a system of redlining maps based on neighborhood "economic soundness", whereby loans in the redlined areas were automatically rejected.[19]

Specifically, FHA appraisers operated under the theory that the economic life of an area decreased markedly when residents of the neighborhood were not of the same social, economic and racial group. The neighborhood rating was critically important in assessing the "economic

soundness" of a mortgage loan; if the economic life of a neighborhood was not sufficient, FHA mortgage insurance was withdrawn from such areas regardless of the merits of individual mortgage insurance applications. The characteristics of "economic soundness" were clearly reflected in FHA policies requiring racially restrictive covenants, in official underwriting manuals, and in appraisal training materials setting forth the relationship between neighborhood stability and locational analysis. In 1956, FHA applications received by the Chicago field office contained a racial designation.[20]

If homes in a neighborhood did not meet the FHA-minimum property standards or the surrounding areas were deteriorated, the appraisers could write off entire blocks as being uninsurable. Under the minimum property requirements for one- and two-unit homes in 1958, an FHA appraiser could reject a home if the lot size was too small, if there was not at least one tree in the yard, if there was either a bedroom or a bathroom adjoining the kitchen, if there were not splash blocks, and for many other even more detailed requirements.[21]

Implementation of the economic soundness policy led to a practice of redlining entire geographic areas of Chicago which the appraisal department considered ineligible for mortgage insurance. Although physical evidence of these maps proved somewhat elusive, it could be shown generally, through their own documents, admissions of past employees, and various committee reports, that the FHA in Chicago redlined areas which coincided with existing inner-city ghetto and transitional neighborhoods.[22] Research for the CBL litigation revealed that the FHA neighborhood files and documents, which

would have been useful in indicating exactly which areas were redlined and the reasons therefore, were destroyed. Persons contacted for such information either would not talk for fear of reprisal or merely spoke in generalities.[23]

We do know that the Chicago field insuring office utilized an automatic rejection procedure based on the geographic classification of loan applications. From 1955 to at least 1961,[24] receiving desk personnel reviewed all applications, rejected and discontinued processing, without a credit determination or property valuation being conducted, all those properties with neighborhood locations designated as "economically unsound" from either of two sources: the red-outline notation in Olcott's Blue Book of Values, a copy of which was kept at the receiving desk, or from the FHA neighborhood ID files on established ratings of locations.[25] A court-ordered pre-trial memorandum of the plaintiffs stated that the Olcott's for 1962 showed that the Chicago FHA office redlined the west side of Chicago to about Kostner Avenue (4400W) from about Roosevelt Road (1200S) to about Madison Street, the primarily residential area into which blacks were moving or had moved (East Garfield Park). According to the same memorandum, North Lawndale, Fuller Park and Englewood community areas were similarly marked off-limits from the time they experienced racial transition until the late 1960s.[26]

Nonetheless, no redlining maps existed after 1969. They had been destroyed after being noticed by a Washington official in use in the regional office in Detroit.[27]

FHA-insured and VA-guaranteed loans represented the only alternative to contract buying for most black households seeking to purchase a home outside the ghetto. Financial institutions would not accept the risk of lending in threatened white or transitional neighborhoods, and the majority of contract buyers nontheless lacked sufficient cash reserves for a conventional mortgage downpayment which averaged 20 to 30 percent. On the basis of the statutory FHA minimum downpayment, the average contract buyer would have qualified for an FHA-insured or VA-guaranteed loan even on the basis of the inflated contract purchase price.[28]

In the FHA Manual, the negative effect on a neighborhood's economic life from changes in "user groups" referred to racially changing neighborhoods.[29] Is there any evidence that the local FHA office extended mortgage insurance in transitional areas in Chicago? Was it aware of the alternative market developing in its absence? Evidence of the geographic pattern of FHA lending in the Chicago housing market available as a consequence of research for the CBL litigation is presented in Tables 3-1 and 3-2.[30] Table 3-1 compares the volume of lending in 1960-1961 between the city of Chicago and outlying areas according to the racial composition of the insured property locations. Racial composition is first classified by census tract within Chicago and by town elsewhere (Columns A and C). For a better indication of neighborhood composition, the black population proportion is further classified according to census block for Chicago city loans which fell in census tracts over five percent black (Column B) and by tract in towns of five percent or more black population (Column D).

TABLE 3-1

Distribution of FHA-Insured Mortgage Loans in Chicago and Northern Illinois, 1960-1961

1960 Racial Composition of Property Location[a]	City of Chicago		Rest of Northern Illinois	
	By Census Tract (A)	By Census Tract (B)	By Town (C)	By Town & Block (D)
Percent black				
Less than 5	64.0	71.7	81.0	87.4
5-29.9	19.8	9.4	19.0	7.6
30-59.9	3.5	2.7	0.0	4.9
60-89.9	5.5	6.3	0.0	0.1
90-100	7.2	10.4	0.0	0.0
TOTAL[b]	100.0%	100.0%	100.0%	100.0%
Number of loans	859	858[c]	4353	4351[d]

SOURCE: Jenner & Block Law Offices, "Study on FHA-Insured Loans", Chicago, June 26, 1975. Includes active and inactive loan files as of 1970. See note 27, Chapter 2, note 30, Chapter 3, infra.

a. U. S. Census of Population, 1960.

b. Columns may not total one hundred percent due to rounding.

c. One loan unaccounted for.

d. Two loans unaccounted for.

Loans in the city of Chicago accounted for a small proportion, 16.5 percent, of the total outstanding loans. The FHA did not insure in the central-city areas of Chicago; in 1960 and 1961, the agency insured only four loans in the central city limits of Chicago between Chicago Avenue and 47th Street. Almost 95 percent of the loans insured in the city were south of 47th Street. The distributions of both city and surburban loans show an inverse relationship between the number of loans and the proportion of minority population. Areas of the city which were more than 30 percent nonwhite held 19 percent of the city's FHA-insured loans.

The pattern of loans in the nonwhite areas reveals that the FHA did make a small proportion of loans in areas that were experiencing racial change during these years, but that such loans were accepted on a very selective basis. No insurance was extended in the older, transitional neighborhoods on the west side. While 162 loans were insured on properties located in census tracts that were still experiencing transition in 1960 (i.e., those tracts classified as penetration, invasion, early consolidation for 1950-1960 with a 1960 black population between five and thirty percent, Table 3-2), the majority of these loans were in one community area, Chatham, an area of much new construction for nonwhites where 11 percent of the housing stock had been constructed within the past ten years.[31]

FHA would insure loans in "orderly" racially changing areas -- where the prices of homes remained stable -- such as Chatham, but it removed itself from racially changing areas in which there was panic selling -- those blocks on which every house had a "for sale" sign in

TABLE 3-2

Distribution of FHA-Insured Mortgage Loans in
Chicago Census Tract 1960-1961, by 1950-1960 Census Tract
Stage of Racial Succession

1950-1960 Racial Classification*	Number of FHA Insured Loans, 1960-1961	Number of FHA-Insured Loans in Transition Tracts with 1960 Black Population Between 5 and 30 Percent
Penetration	11	4
Invasion	235	158
Early Consolidation	17	--
Consolidation	21	--
Late Consolidation	7	--
Piling Up	25	--
Subtotal	316	162
White	543	--
TOTAL	859	162

SOURCE: Jenner & Block Law Offices, Memorandum, "FHA Insured Loan Study, 1960-1961", undated research materials.

* See Table 2-1 for definitions.

front of it -- because of the uncertainty regarding values. Lenders cognizant of FHA's insurance policy would rarely submit applications in racially changing areas; contract sales were the only way to get a sale in those areas.[32] Comparison of FHA lending activity with contract sale activity reveals an inverse relationship between the existence of FHA-insured loans and contract sales. Between 1960 and 1961, there were only ten census tracts in Chicago with evidence of both types of financing. In effect, there was no real choice. FHA-insured lending in all but two of these census tracts represented token activity of four or fewer properties. In at least two other tracts, earlier contract activity had signaled transition. Except in Chatham and Washington Heights, one generally found evidence of contract activity predominating in early transition tracts.

"To a greater extent than ever before the use of land-contract sales among Negro buyers in Chicago is a growing evil." This response, given by the director of the Chicago FHA insuring office to a 1959 Congressional inquiry concerning practices in the low equity sector of the "conventional" mortgage market,[33] reveals the fact that the FHA knew how and under what conditions the gap in the supply of housing finance was serviced although they did not believe themselves to be at fault. Furthermore, in the early 1960s as part of the feasibility analyses of urban renewal areas, the FHA conducted studies on contract sales in several cities. The aim was to develop a program of home renovation and rehabilitation through financing rather than to destroy the homes through urban renewal. Research uncovered the fact that buyers had high contract balances which made it nearly impossible to obtain

conventional mortgages or construction loans. According to the FHA administrator in charge, many sellers admitted that the sale prices of the contracts were "greatly" inflated. In cities other than Chicago, he negotiated substantial reductions on the outstanding contract balances. Unable to obtain any help from the city of Chicago through its urban renewal program and unable to devise any other means of pressuring contract sellers to reduce the amounts outstanding on their contracts, he was "completely unable to obtain negotiations of contracts in Chicago."[34]

If one cannot definitively prove that the Chicago FHA office redlined neighborhoods on a discriminatory basis, their failure to insure loans on an open occupancy basis[35] and in almost all racially changing areas, was certainly a contributory cause of the speculative opportunities and the gross price fluctuations which ensued and thereby foreclosed the possibility of FHA activity.

In retrospect it is easy to attribute social liability to the FHA for not insuring in older inner-city neighborhoods. While FHA-insured loans had long provided mortgage credit for low equity purchases, it did so only for those properties that permitted the insuring agency to operate on a self-sustaining basis; given FHA underwriting and construction standards, loans were concentrated in the middle-income, new suburban market. The availability of FHA and VA mortgage loans in Chicago further suffered from general programmatic constraints common to such loans in most urban areas: high discounts to offset the low statutory contractual interest rate, high construction costs, bureaucratic red tape and, in Illinois, a lack of mutual savings banks,

commonly large holders of such mortgages.[36] Conventional lenders did not see the benefits of the government-backed mortgage loans since, with the addition of the insurance premimum, the total interest rate often exceed the conventional interest rate.[37] Indeed, the effects of these factors are revealed by the fact that by the end of 1959, a smaller proportion of veterans in Illinois had made use of the VA-guaranteed mortgage program than in any other major state in the country.[38]

Not until 1965 did the FHA officially recognize the effects of its "automatic exclusion and rejection" policy.

> In some instances there has been hesitancy on the part of insuring offices to make FHA programs available in older neighborhoods. An automatic exclusion of neighborhoods merely because they are older can result in the shutting off of capital investments in these neighborhoods. Unavailability of capital, in turn, accelerates decline.
>
> Directors should at all times be aware of the characteristics and changing patterns of residential areas within their jurisdiction. They should be alert to situations in which values can be stabilized and property upgraded by an infusion of capital in older residential sections and should help bring this about by seeing that such areas are not denied the benefits of mortgage insurance.[39]

The irony of FHA's new market position was that it was given a directive to intervene as a lender of last resort, to supply a service and to reverse a legacy of neighborhood consequences and institutional attitudes which it had fostered.[40]

INSTITUTIONAL FINANCE OF SPECULATIVE TRANSACTIONS

Mortgage lending practices commonly adhere to conservative principles of investment consistent with the fiduciary responsibilities of financial intermediaries. The industry's model of "good" lending

behavior was predicated upon no lending to black households in white neighborhoods, no lending in racial transitional areas until price stability returned, and risk minimization through conservative lending limits. While it was the role of the FHA-insured sector to service low equity purchasers, the FHA itself set the standard with respect to neighborhood homogeneity.

The structure of financial markets in Chicago reinforced the conservative disposition of financial intermediaries. Unit banking areas such as Chicago tended to collect the lowest volume of long-term savings in local financial institutions, and commercial banks in Chicago in the late 1950s and early 1960s placed less funds in mortgage loans relative to savings deposits than banks in most other areas.[41] Without mutual savings banks, the savings and loan associations provided the bulk of mortgage lending funds and only a handful wrote FHA-insured mortgages.[42] A 1959 Chicago survey showed that of the 243 savings and loan associations in Cook County, only 21, including the two black associations in the city, had made loans in the heavily black-populated south side area during the preceding twelve months. Only one white association had made an initial mortgage loan to a black family in a white neighborhood.[43]

The direct involvement of savings and loan associations in the contract market clearly deviates from the conventional practices of the time. Were these associations aware of the type of security collateralizing the mortgage, the absentee ownership of the mortgagor, the installment contract sale? What were the costs and benefits of financing

speculative mortgage loans? Did the involved associations represent a deviant class of mortgages?

Investors in Speculative Real Estate Transfers

Just as the dual housing market fostered a realty vacuum for speculative transactions, it also fostered a financing vacuum. Impending and ongoing neighborhood racial change led to a reduction of local mortgage money in transitional areas and provided a ready market of profitable lending opportunities for those lenders who understood how to assess and price risk in these neighborhoods.

The contract market was composed of an outside set of money lenders financing speculative activity just as it was composed of an outside set of real estate investors. In 1960, there were 289 savings and loan associations in the Chicago metropolitan area. At least 55, or 19 percent, of these institutions had loans outstanding to speculators in the installment contract market after 1955; yet only 34 of these associations were located in the city of Chicago and a mere 7 were located in those community areas with contract sales activity.

Savings and loan associations were not the sole financiers of the contract market; while their mortgage underwriting activities accounted for 73 percent of the contract properties in the data set, the residual 27 percent was financed by other institutional lenders, local black life insurance companies, local ethnic fraternal organizations, and individuals, mortgage companies, and investment syndicates.[44]

Individuals and investment syndicates have traditionally provided financial leverage for risky investments. The subordinate role of these

"other" investors in the contract market can be attributed to the unusually large-scale involvement of several savings and loan associations with those speculators accumulating the largest portfolio of contract properties. Sample data reveal a temporary decline in the relative usage of other mortgage money sources during the period of heavy SLA involvement between 1959 and 1963. Except on the south side where there were fewer SLAs willing to invest heavily in speculative mortgage finance, small-scale speculators relied on these non-SLA sources almost twice as frequently as large-scale speculators. A comparison of the costs of mortgage finance by type of mortgage lender, presented in Table 3-3, shows the costs of SLA mortgage finance to be lower than the costs of other sources of mortgage finance. Speculators undoubtedly preferred SLA mortgages. These mortgages were written for longer terms with lower interest rates and fewer discount points than mortgages written by other financiers. The difference between the mortgage payments and the contract receipts, the monthly gross cash flow to the speculator, was greater for SLA mortgages than for other mortgages.

Aside from the profit-making goal of a high investment return, why would ethnic fraternal organizations such as the Polish Roman Catholic Union of America and the Polish National Alliance of the U. S. finance the disruptive, speculative activities of dealers operating in their clients' neighborhoods? Why would black-owned or managed financial institutions underwrite speculative contract purchases rather then direct mortgage loans?

TABLE 3-3

Selected Financial Characteristics of Contract Transactions by Type of Mortgage Lender 1955-58, 1959-64, 1965-68

Mean Value	1955-1958	1959-1964	1965-1968
	Savings and Loan Association		
First Mortgage Characteristics			
Interest rate (percent)	6.05	6.64	6.39
Discount fee (percent)	3.60	4.17	2.18
Term (years)	11.2	13.4	15.5
Loan amount ($)	9443	11699	13125
Loan-to-price ratio (percent)	77.02	95.73	122.2
Appraisal-to-price ratio (percent)	129.0	138.4	132.0
Contract Transaction Characteristics			
Monthly gross cash flow ($)	57	47	53
Gross cash investment ($)	61	-242	-2628
number of observations	51	270	9
	Other Mortgage Lender		
First Mortgage Characteristics			
Interest rate (percent)	6.10	6.56	6.75
Discount fee (percent)	9.00	9.32	9.52
Term (years)	9.5	10.5	6.7
Loan amount ($)	8417	2979	7627
Loan-to-price ratio (percent)	88.82	100.48	93.33
Appraisal-to-price ratio (percent)	na	131.0	na
Contract Transaction Characteristics			
Monthly gross cash flow ($)	49	34	36
Gross cash investment ($)	-141	-66	18
number of observations	53	75	8

na = information not available.

With the exodus of conventional sources of mortgage funds in racially changing neighborhoods, the immobility of real estate transfers inhibited the locational choices for resident ethnic whites as well as potential black entrants. It is the recognition of this constraint which most likely provided the impetus for the financial involvement of the ethnic fraternal organizations.[45] Financing the contract transactions of speculators represented the counterpart to financing suburban residential choice since it provided the cash resources necessary to purchase homes from whites desirous of leaving the old neighborhoods in the wake of racial change.

In contrast, the involvement of black-owned or managed institutions was both more complex and widespread. As part of a broader institutional family of either life insurance companies or savings and loan associations, the behavior of these black institutions was conditioned by the attitudinal and procedural norms, and regulatory guidelines of each industry. In both of these industries conventionally accepted principles of mortgage underwriting procedurally prohibited lending in racially changing neighborhoods. While these black institutions were cited as pioneers in lending in emerging black neighborhoods,[46] the exact location of these loans and the timing of this lending vis à vis initial transition was unclear. The CBL information on contract buying targeted one aspect of this institutional involvement. Black life insurance companies financed contract speculators. It is unclear exactly why these companies chose to finance speculators rather than buyers directly. Apart from the high returns attainable, one can only suggest that since life insurance companies are not mortgage originators but purchasers of mortgages from local correspondents, the

probability of direct mortgage placement with black buyers was small.

If the speed of Negro residential expansion was limited by the resources of Negro-owned life insurance companies and savings and loan associations, as noted at the housing hearings held by the U.S. Commission on Civil Rights in Chicago in 1959, it is unlikely that the contract market would have attained such an impressive scale. Table 3-4 presents a comparison of the size of these black companies with the size of the major white institutional investors in the contract market. The testimony at the Civil Rights Commission hearings most likely reflected the major role black institutions played in financing homeownership through direct purchase and mortgage transactions in established black neighborhoods rather than in the broader Negro homeownership market, because the development of a large-scale contract market was clearly dependent upon the participation of larger white institutions.

Mutual Benefits from the Lender-Speculator Relationship

Mortgage finance provided the lubricant for the contract market. While entry into the market was technically wide open, it was dependent upon securing an adequate and often continuously reliable source of mortgage finance. A speculator's volume was necessarily limited by the number of his financial contacts, or the size of his prime source institution and its commitment to financing contract transactions. Without financial leverage, sales volume was a function of a speculator's personal resources.

TABLE 3-4

Asset Size of Major Savings and Loan Associations Involved in Financing the Contract Speculators Compared with Black-Controlled Institutions: 1960, 1966

Institution*	1960	1966
Gotham SLA	17,297,261	35,881,704
Dividend SLA	19,931,600	27,967,946
Dusty SLA	3,780,051	5,433,436
Provident SLA	25,184,357	Liquidated
Major SLA	2,974,938	3,831,549
Ring SLA	3,679,783	7,945,280
Lake FSLA	26,939,221	41,633,672
Avon SLA	4,706,133	10,434,868
World FSLA	7,296,516	11,385,760
Colonel FSLA	33,666,260	54,702,687
Black-Controlled Institutions		
County FSLA	11,427,698	17,332,301
Trust FSLA	5,099,980	7,813,786
South Insurance Co.+	23,468,565	33,339,732
City Insurance Co.	13,353,306	19,314,360
Assured Life Insurance Co.	6,683,393	7,835,096

SOURCE: Federal Home Loan Bank of Chicago, Directory of Members, 1960, 1966. Best Insurance Directory, Life Insurance Companies, 1960, 1966.

* Names represent pseudonyms. Listed in decreasing order of participation in finance of speculative transactions in the installment contract market.

+ Only black institution known to have had a large involvement financing speculative transactions in the installment contract market.

The sources of finance differed between geographic market sectors, but the characteristics of mortgage finance enabled all large-scale contract sellers to speculate in contract properties with little or no cash investment. While average gross cash investment for all sellers was low, it was lower for large-scale sellers, $23 compared to $388 for the small-scale seller.[47] On the west side, all large-scale sellers secured more than half of their mortgages from a single SLA; the two largest sellers used the same institution, Gotham Mutual Saving Association.[48] On the south side, while several other SLAs made multiple loans to individual speculators, a pattern of concentrated mortgage lending by a few lenders did not develop. Non-SLA mortgages were twice as prevalent, and speculators spread their mortgage loans among several associations.

In addition to the leverage function, mortgage finance of contract property allowed the speculator to shift the risks of contract selling to a third party without sacrificing his high investment return. By interposing his credit between the lending institution and the contract buyer, the speculator successfully arbitraged conventional credit constraints facing the low equity contract buyer in transitional neighborhoods. In the process, however, the lender bore most of the risks, since both the borrower and contract buyer had little or no equity invested. The fact that the speculator in most cases was not personally liable since the land trust account was the legal mortgagor further decreased the risk to the seller. In case of contract buyer default, property deterioration or a decision to disinvest, the speculator could, and often would, default on the mortgage note, leaving the

association with few options but to foreclose on the loan.

Mortgage loans made to speculators for the purpose of financing property acquisition to be sold subsequently on an installment contract were characterized by high interest rates, high loan origination fees, and short maturities. These higher rates and shorter terms could be attributed to high risk or to market imperfections which limited the availability of funds in this particular market and caused some borrowers to pay higher-than-average rates and fees to obtain financing.

Within the lending industry, it is generally conceded that, all other things equal, loans to nonresident owners, on older buildings, and in racially changing neighborhoods represent greater risks to the lender because of the greater uncertainties of expected loan returns. When the borrower-contract seller is interposed between the lender and the buyer whose income provides the funds for payments, the lender loses his customary control over a critical underwriting standard -- the ratio of borrower income to loan payments. The inflated price of a contract sale compounds the risks. In such a situation the risk burden of the loan disproportionately falls on a single component -- the value of the real estate security. Both seller and buyer often have little invested capital.

However, while the mortgage terms to contract sellers reflected a perception of higher than average risk -- higher interest rates, shorter maturities and higher loan premiums -- the very high loan-to-purchase price ratio reveals the true liberality of the mortgage loan. This ratio increased over time from 77.4 percent for the period 1955-58

to 95.7 percent for mortgages granted between 1959 and 1964 (Table 3-3).

The fact that contract sales have most frequently been utilized as a means of initiating neighborhood transition subjects lenders to the additional risks of price instability which purportedly keeps them from making "integration" loans. (Price stability in the market following initial transition often fails to sustain the high level of housing prices and rents generated earlier and captured by speculators in long-term contract payments.) When lenders are aware of the techniques of real estate investors engaged in contract sales of properties in racially changing neighborhoods, the risks they accept when making mortgages on these properties are greater than the risks of lending directly to prospective homebuyers at similar mortgage terms.

To justify the investment on an individual loan basis, the higher risk of lending to a nonresident owner theoretically need only to be compensated by a sufficient return. Yet the most salient characteristic of SLA involvement in the finance of contract properties is not that it deviated from the low-risk loan, but that several associations made multiple high-risk loans to several speculators. Four SLAs accounted for 48 percent of the SLA-financed mortgages;[49] loans from Gotham Mutual Savings Association accounted for over 45 percent of these loans. In practice, it was the portfolio concentration of risky loans which compounded the risk attributable to a particular loan.

> Consider a hypothetical example of an association entering into a lending program where it expected that one-fifth of its loans would default, and the recovery rate on these loans would be 50 percent of the loan balance. In order to

> produce a 6 percent average return on its entire portfolio, the association would have to earn a rate of 20 percent on the remaining four-fifths of its loans.[50]

Why would an association make these loans at high loan-to-purchase price ratios? One answer, of course, is that the expected profit from the high interest rate and high loan premium was a sufficient inducement for the lender. As shown in Table 3-5, the average interest rates and origination fees of mortgage loans on speculative contract transactions substantially exceeded prevailing mortgage rates on existing homes in Chicago.

The exceedingly high loan-to-purchase price ratios can partially be attributed to the fact that speculators generally purchased property from white homeowners at distressed prices. But laxity in administrative procedures, excessive overappraisals and a willingness by favorably disposed lending officials to make loans at greater than 80 percent of appraised value are equally responsible.[51] Mortgage applications often had no bearing on the subsequent loan. They were completed after an oral commitment, or forms signed in blank by most large-scale speculators, were completed at the convenience of the association.[52] The effect of these lending procedures was a high loan-to-price ratio while the loan-to-appraisal value ratio conformed to the lending regulations.[53]

In these speculative mortgage finance arrangements the lender clearly held a superior bargaining position. While the costs of such mortgages were high relative to conventional mortgage rates, the astute lender understood that this was scarcely a constraint on the speculator's ability to generate a high return. Such a return was almost always forthcoming. First, the prevailing contract market prices, when con-

TABLE 3-5

Characteristics of Conventional First Mortgage Home Loans for Existing Homes Originated by Major Lenders Nationally, in Chicago SMSA, Compared with Characteristics of Mortgage Loans Made to Speculators in Chicago, Selected Years

Type of Loan and Loan Characteristics	Annual Averages		
	1963	1964	1965
Loans for purchase of existing homes, U. S. average *			
Contract interest rate (%)	5.98	5.92	5.91
Nonrecurring fees & charges (%)	0.65	0.56	0.51
Loan term to maturity (years)	19.7	20.1	20.6
Loan-to-purchase-price ratio (%)	71.6	71.6	72.4
Purchase price ($)	18,700	19,200	20,200
Loans for purchase of existing homes, Chicago SMSA *			
Contract interest rate (%)	5.60	5.58	5.57
Nonrecurring fees & charges (%)	1.25	1.03	0.90
Loan term to maturity (years)	20.8	21.2	21.1
Loan-to-purchase-price ratio (%)	70.7	72.8	70.7
Purchase price ($)	23,300	23,000	25,200
Loans for purchase of existing homes by nonresident owner for speculation, Chicago +			
Contract interest rate (%)	6.69	6.48	6.29
Nonrecurring fees (%)	4.06	3.08	2.50
Loan term to maturity (years)	14.6	13.2	15.0
Loan-to-purchase-price ratio (%)	100.3	103.7	123.3
Purchase price ($)	11,336	11,781	7,550
number of observations	33	24	7

SOURCE: Federal Home Loan Bank Board, Office of Public Affairs, News Release 1963, 1964, 1965, 1966.

* Average terms based on a sample of lenders.

+ Average terms based on a sample of newly originated loans made by lenders to speculators for property acquisition subsequently sold in an installment contract.

verted to a chash flow relationship between mortgage expense and contract payment, yielded a large cash flow which minimized the time period necessary for the speculator to recapture his initial investment. Second, the initial cash investment was generally so minimal (or negative) that returns were high regardless of the absolute dollar cash flow. This superior bargaining position was buttressed by the logistics of real estate transactions; the ability to purchase a building was often contingent upon obtaining a loan commitment prior to closing on an acquisition.

A second reason for liberally granting speculative mortgage loans was that loan losses were not anticipated -- the lender believed he had a "secure loan due to the fictitiously high price on the property. Or, if more sensitive to the risk involved, he may still [have believed] that the high yield on such loans amply compensated for the risk involved."[54]

> We feel that the security to the amount of the loan is far in excess of any security obtainable in any other area of the city of Chicago...We feel that with the small amount of mortgage loan, short term of mortgage, and repayments of principle averaging $1,000 per year per mortgage, our loans are fully protected.[55]

Alternatively, since a majority of the contract properties were two- or three-flat buildings, the lender may have been persuaded that the property was worth more than the acquisition price by using an income approach to value. With the market more circumscribed for the black renter and the low income rental supply diminished during the previous decade due to urban renewal demolitions, higher "rents" could be charged to the black compared to the white renter for the same

space. Higher rental income would support a higher valuation for the property and thus a larger loan.[56]

In 1961, the directors of Gotham MSA, the largest investor in the contract market, saw no particular danger in a concentration of loans to a limited number of real estate investors. To justify their position, they reversed the commonly accepted principle that loans for nonowner-occupied dwellings carried greater risk. The ambiguous perception of contract buying permitted this type of flexible thinking; both parties -- contract buyers and sellers -- thought of themselves as owners.

> Our records show these contract purchasers value their newly acquired real estate more than the former owner, and collection experience has been excellent.[57]

Yet when borrower-seller delinquencies became epidemic, this association reversed its stand regarding the risks attendant upon these contract sales transactions:

> [There are] many responsible contract purchasers living in these properties. These people, for the most part, have been sold the property at a ridiculously high contract price, which made the monthly payments almost impossible.[58]

A likely motivation for the lending practices being pursued by several associations was the opportunity for personal enrichment. It was common knowledge among those familiar with the dual financing arrangements in the contract market that many of the officers of participating savings and loan associations benefited from under-the-table payments. Indeed, several gained a reputation for financing speculative transactions; sellers were aware of the associations "that would loan on these properties -- that would loan in these areas."[59]

> Frequently these brokers go out into other neighborhoods and for cash bonuses persuade the savings and loan officers out of the neighborhood to make 70 or 80 percent loans. They'll charge 1 percent or 2 percent legally and 2 percent or 5 percent extra bonus in cash paid off to the officers of the savings and loan for making these high loans.[60]

The method of closing mortgage loans through escrow accounts and disbursing the net proceeds (after deducting loan fees and charges) to the escrow account with the instructions "Pay the proceeds of the loan to borrower" facilitated the payment of higher than stated premiums, referral fees, kickbacks.

At Gotham, a mutual asscoiation, the president benefitted from a bonus arrangement whereby he received 25 percent of net earnings after dividends and before allocations to reserves.

> Association earnings were, of course, magnified by the high interest rates and large loan premiums charged to borrowers on risky loans. Even though a portion of loan premiums was deferred and taken into income in subsequent years, $161,000 or about 25 percent of gross income during 1959 consisted of premium income. Deferred premiums shown on the association's balance sheets were about $180,000 at the end of 1959 as compared to less than $12,000 a year earlier. Therefore, the president stood to receive an additional $40,000 bonus in subsequent years from loan premiums collected in 1959. Furthermore, the president and other top officers and directors of the association split loan fees and appraisal fees charged borrowers on new loans, without taking these fees into association income.[61]

Many associations involved in the contract market sought high-rate, high-fee, and frequently high-risk loans as an accommodation to changes in the financial marketplace. The associations with the largest involvement all experienced rapid savings growth in the late fifties and early sixties (Table 3-4) as a consequence of extensive advertising, expensive promotion gifts, high dividend rates and commissions paid to savings

brokers. During the same period, 1959-65, changes in mortgage and savings rates produced an "earnings squeeze" in the savings and loan industry. In 1960, conventional mortgage rates began to decline. By mid-1963 rates had stabilized at about 5.8 percent, down from 6.3 percent in 1960; they did not increase again until the end of 1965. The average rate paid on savings accounts concomitantly continued to rise from 3.9 percent in 1960 to 4.2 percent in 1965.[62] Some associations considered high-yield loans a necessary means to increase their loan portfolio return. The high return was necessary if the association was to maintain the 1960 point spread and continue to attract and to pay for savings.

Concentrations of High-Risk Loans to Real Estate Speculators

There is ample evidence to demonstrate that most of the involved associations were well aware of the characteristics of the mortgaged property, the borrower-beneficiary relationships behind loans made to trust accounts, and the intended usage of mortgage proceeds to finance sales on installment contracts. The appraisal documents used by several associations in the late fifties and early sixties explicitly requested information on the racial composition of a neighborhood through the following types of questions: "colored or white purchaser?", "racial composition of the neighborhood?", "distance from colored?"[63] Appraisal forms similarly requested information on the intended usage of the property with a printed designation for contract sales: "Premises are occupied by: owner__, tenants__, contract purchaser__," or "Land Contract: Purchaser__."[64]

A majority of the mortgage loans made to a trustee of a land trust account represented multiple loans to one real estate speculator. Administrative procedures facilitated concealment of these multiple loans to a single borrower. Supervisory examiners often found that the mortgage notes were rarely signed by the beneficiary(ies) of the trust; in several cases, they were unable to find trust agreements and therefore concluded that the association never concerned itself with the real beneficiaries.[65] At least one association did not require the applicant-beneficiary to certify his total indebtedness to the association when applying for a new loan.[66]

Knowledge of the risks involved in financing speculative real estate transactions gained through the slow, but steady accumulation of loan delinquincies beginning in late 1961 and early 1962 did not persuade some lenders, signficantly the four associations with the largest portfolio of loans secured by contract sale properties (Table 3-6), to discontinue high-risk lending, which in one case was characterized by supervisory examiners as "hazardous mortgage lending practices."[67] The examination report for this association for the following year (1963) revealed that loans in the Lawndale-Garfield Park area, noted by examiners as a "blighted neighborhood", increased by 91 percent to $10.3 million during the fourteen-month period between examinations. This lending concentration represented more than one-third of Gotham Mutual Savings Association's outstanding loans. During this period the two largest borrowers, who were also the two largest west side contract market speculators, Boston and Hicks, were granted 230 and 90 loans, respectively, for a total of $3.7

TABLE 3-6

Selected Lending Characteristics of Savings and Loan Associations with the Largest Concentrations of Loans Financing Contract Sale Transactions

	Combined Lending Concentrations,* all years
Sample number of loans, all years	169
Percent of all newly originated SLA mortgages+	48.2
Dollar volume of sample loans	1,871,283
Percent, dollar volume of sample loans	49.7
	Average Mortgage Loan Characteristics for Newly Originated Mortgages, 1959-64
Interest Rate (%)	6.83
Discount Fee (%)	4.71
Term-to-Maturity (years)	13.0
Loan Amount ($)	11,925
Loan-to-Purchase Price (%)	90.59
Appraisal-to-Price Ratio (%)	132.70
Number of observations	141

* Gotham Mutual Savings Association, Dividend SLA, Dusty SLA, Provident SLA.

\+ Newly originated savings and loan association mortgage loans represent 59 percent of the sample properties with mortgage financing; the residual mortgages were placed with other institutional sources, or privately.

million. This magnitude of new loans corresponded to a period of "substantial" increases in slow loans; as of the 1962 examination, slow loans amounted to $674,000 or 2.1 percent of net assets compared with $56,000 or 0.3 percent of net assets a little over one year earlier.[68]

Despite the heavy volume of delinquencies (including real estate owned and in foreclosure) which had increased to 7.8 percent of net assets by March, 1963, Gotham continued to "expand its lending in this area to the same borrowers, albeit at a slower pace than in previous years."[69] Later that year, the depth of the delinquency problem finally caused the association to revise its lending policy. By the end of that year, loans outstanding in the Lawndale-Garfield Park area had reached $11.7 million or 37 percent of all outstanding loans.[70]

Another smaller association following a similar pattern of concentrated, high-risk loans to a few borrowers also experienced a build-up of slow loans and real estate owned or in foreclosure in the early sixties.[71] A 1963 report recommended that test appraisals be made on a few properties securing loans granted by the association.[72] At the time, slow loans and contracts represented 1.5 percent of net assets. In the next nine months, association officers approved 48 loans in the West Garfield and Englewood community areas; 26, or 54 percent were granted to realtors or other persons for speculation.[73] Loans in these two communities then represented over 49 percent of the association's loan portfolio; 31 percent on the west side, 18 percent on the south side. During this period slow loans and contracts

accumulated to 5.3 percent of net assets. Nonetheless, lending practices in the next year, 1965, continued to reflect those of the past; all loans were granted for properties in the older sections of Chicago with fifty percent going to nonresident owners.

Provident SLA also followed the now familiar practice of granting multiple loans to speculative real estate investors. Examination of this association's lending operations revealed a "situation of undue risk" to the Federal Savings and Loan Insurance Corporation.[74] Nonetheless, between 1959 and 1962, the number of such loans in force to the two largest of seven speculator-borrowers increased from 51 to 132, or nearly $1.8 million, which represented 5.7 percent of the association's total loans in force.[75] One of these borrowers was Boston, the single largest borrower at Gotham Mutual.[76]

At a time when delinquencies on the west side had become prevalent, the executive vice-president of yet another significant financier of the contract market asked for some "cooperation" in curing these loan delinquencies, given "all the consideration you got from us over the past years." A month later he wrote: "Kindly send me your check for the delinquency, I may be able to do something for you some day."[77] The letter is dated December 12, 1966, a time when neighborhood deterioration was clearly evident in these west side neighborhoods.

Why would an association continue to make loans of this quality? One explanation is that management exercised poor judgment in assessing the probable losses from loan concentrations; as the number of nonearning assets increased, increases in SLA income from

origination fees and high-rate loans provided a means to meet dividend and reserve payments. Another reason is that there may have been a conflict of interest between a savings and loan business and real estate affiliate.[78] Yet another is that those who controlled the association concentrated on short-term profits at the expense of long-term solvency. At the time most of these loans were granted, Illinois State law and FSLIC insurance regulations did not prohibit such concentrations of lending; beginning in February, 1963, federal insurance regulations prohibited only the concentration of loans to one borrower.[79]

As federally insured associations, the risks threatening institutional solvency posed by concentrations of high-risk lenging were ultimately shifted to the Federal Savings and Loan Insurance Corporation (FSLIC). Between 1963 and 1971, 23 federally insured savings and loan associations in Illinois[80] (18 of which were state chartered) experienced financial difficulties severe enough to warrant financial assistance from the FSLIC.[81] This group included three of the four largest lenders discussed in the previous pages, and eight other SLAs which were involved on a smaller scale in the finance of contract properties. Only in the former cases can the financial difficulties of the associations be attributed to speculative loans on contract properties. Mortgage loans to contract sellers granted by the latter eight associations were part of broader high-risk loan policies which included speculative loans on land purchases and new suburban housing developments. The demise of many associations in this latter group can also be attributed to criminal embezzle-

ment and fraud.[82]

One of the rescue actions taken by the FSLIC was to purchase some or all of the assets of these "problem" associations. A court document provides an estimate of the magnitude of FSLIC acquisition of contract properties for five of the associations which failed between 1963 and 1968; the document listed 668 properties.[83] (This figure does not include those properties subsequently acquired through FSLIC actions taken to facilitate mergers for Dusty SLA and Colonel SLA.)

Combined loan activity from the eleven "problem" associations accounted for 42 percent of the contract sale sample properties (Table 3-7) financed with newly originated mortgages from SLAs. Gotham respectively provided mortgages for over 63 and 80 percent of the sample contract properties of Boston and Hicks; Provident granted mortgages to Cone for 51 percent of his sample contract properties. As preeminent suppliers of capital for the west side's largest real estate investors, the scale of participation in the contract market by these associations reflected a short-term mutually beneficial arrangement which undoubtedly accounted for the rapid growth in volume of contract sales by these sellers. If a real estate investor can obtain favorable financing he can sell more readily. Despite the high costs of the loan, the high loan-to-purchase price ratio minimizes the cash investment and maximizes the return while the costs of this mutually beneficial arrangement are passed along to the contract buyer. Since a buyer with a small downpayment, particularly a black buyer, cannot afford to be price conscious, contract prices can be inflated to cover

TABLE 3-7

Selected Lending Characteristics of "Problem" Illinois Savings and Loan Associations Involved in Mortgage Finance of Property Sold on an Installment Contract

	Combined Lending Activity, all years	
	"Problem" Associations*	All Other Associations
Sample number of loans, all years	145	231
Percent of all newly+ originated SLA mortgages	42	58
Dollar volume of sample loans ($)	1,545,133	2,189,800
Percent, dollar volume of sample loans	41	59
	Average Mortgage Loan Characteristics for Newly Originated Mortgages, 1959-64	
	"Problem" Associations	All Other Associations
Interest Rate (%)	6.79	6.53
Discount Fee (%)	4.52	3.89
Term-to-Maturity (years)	13.2	13.5
Loan Amount ($)	11,465	11,932
Loan-to-Purchase Price (%)	94.67	96.48
Appraisal-to-Price (%)	140.0	137.2
Number of observations	121	146

* "Problem" associations are those SLAs which became insolvent between 1963 and 1973 and required assistance from the FSLIC; their offices were subsequently closed or merged with stronger SLAs. Three out of the four major SLA lenders listed in Table 3-6 were "problem" associations.

\+ Newly originated savings and loan association mortgage loans represented 59 percent of the sample properties with mortgage financing; the residual mortgages were placed with other institutional sources or privately.

high finance expenses yet still generate high returns.

The causes of several of these institutional failures stem from following a policy of lending which represented three types of concentration -- in a limited geographic area, in a few borrowers, and in nonowner-occupied dwellings. The fact that these buildings were also sold on contract at inflated prices compounded the risks. In the case of Gotham Mutual, this combination had a synergistic effect on loan quality.

> Property values in the area declined, the principal borrower died, and because of this, contract buyers abandoned their property and tenants ceased paying rents. The buildings securing the loans were in many cases vandalized or gutted before the association could secure possession through foreclosure.[84]

On an individual basis the high-rate, high-risk loan was not a detrimental factor of loan quality.

> We do not wish to take the position that no loans at all should be made in the areas in question [Lawndale and Garfield Park]...We are confident that there are some which would stand the test on a sustained quality basis. It is rather the concentration of these loans that is disturbing.[85]

> Included in these [loans made in declining areas] were loans made for nonresident speculative investment income purposes, either through resale, contract agreement for deed or rental. It is commendable for associations to recognize and assume their responsibilities to their immediate neighborhood or community. It is conceivable that such efforts through loans for homesteads will affect to arrest any decline in values within the area serviced. Such steps taken in some localities can be successfully attested to toward rehabilitation. However, this office cannot agree that absentee ownership in loans made in their behalf can be inducive to the elimination of blight and towards permanent efforts for improvements.[86]

Rather, it was the concentration of such loans over time. One major supplier of mortgage capital, Dividend SLA, did not develop into a problem association, nor did its savings deposits grow as rapidly as

those of Gotham Mutual. Its survival could have been due to a policy of retrenchment instead of continued investment in high-yielding risky loans.

All too often the literature analyzing the role of the speculator as mediator between white and black housing markets overlooks the financial connection, the source of capital necessary to sell the transferred unit either with a mortgage or with a contract. The availability of mortgage finance was a critical institutional determinant supporting the contract market and a key factor maintaining the segmentation of housing markets by race. A "no integration" policy toward mortgage loans to black households seeking to expand beyond the ghetto effectively controled this aspect of access to the larger white market. And control of access determined the economic environment of contract sales. Until 1965, the government, through its agent, the Federal Housing Administration, implicitly supported policies and practices that fostered the development of a realty and financing vacuum in white neighborhoods adjacent to established black areas. The contract sales market flourished in that vacuum.

Blockbusting activities and contract sales stand as countervailing forces to the unwritten restrictions on black residential expansion exercised by real estate and financial intermediaries. The ability of the speculator to break through the white market's barriers rests upon his willingness to reject the professional norms of the real estate industry and his ability to find alternative sources of mortgage finance, in a trade-off of reputation and professional security for uncertainty and expected high short-term profits. His

ability to exact high profits derives, not from individual controls on market price, but from a superior bargaining position conferred by the negative actions of institutions inhibiting direct access by black home buyers.

CHAPTER 4

Price and Profit in the Installment Contract Market

Defendants in effect contend that this [price in excess of fair market value and of what whites pay for comparable housing] is solely a matter of economics and not of discrimination. We cannot accept this contention for although the laws of supply and demand may function so as to establish a market level for the buyer in the black housing areas, it is clear that these laws are affected by a contrived market condition which is grounded in and fed upon by racial discrimination -- that is, the available supply of housing is determined by the buyer's race.

U. S. Court of Appeals, 7th Circuit
Clark v. Universal Builders, Inc., July 20, 1974.

The creation and support of a dual housing market evolves from restricted access to the white market. Racial discrimination in this context is less likely to manifest itself through overt refusals to sell or through differential terms of sale, the traditional conceptualization, but through numerous incremental, subtle actions and institutional practices which restrict direct black entry into the white housing market. Racial barriers delay and shape the expansion of the black neighborhood. An observable short-term consequence is a decrease in the supply of housing and price increases within the restricted market. To transfer a unit to the black market blacks must pay an economic, and often psychological, premium. While economic and political forces dictate that this expansion cannot be halted, institutional restrictions place the black consumer in a captive market position, one devoid of meaningful choice.

Given this situation, other individuals use their superior economic and social position to profit from market inequities. Assuming that one could empirically estimate a "white price" for a particular transaction in this market,[1] the economics of a restricted market makes

it conceptually erroneous to look at the price differential between white and black market price and attribute it to the discriminatory actions on the part of the ghetto speculator. The comparison is one between two different opportunity sets: the black market, with its large demand and artificially restricted supply, and the white market with its relatively free market adjustment of demand and supply.

> If the ghetto realtor just accepts the highest bids as offered he has done nothing to cause the prices to be different from those in white areas. As long as he has competitors in the black market, and absent a price-fixing conspiracy, when a seller "charges what the market will bear" he engages in auction-like activity in which it is presumed that the market, not he, controls the price level. There is an abundant supply of black buyers who will outbid whites for property in ghettos and changing neighborhoods. No white sales will occur unless that supply is exhausted, because no rational businessman will sell for less as long as there are customers willing to pay the going rate.[2]

Unlike pure racial price discrimination, the causal link between discriminator (market restrictor) and victim under the dual market hypothesis is usually remote, with the discriminatory practice operating more in the aggregate than in individual cases.[3]

The segmented structure of urban housing markets defines not just the relative price black households must pay for housing, but the conditions under which units are transferred between markets. In a unified market buyer and seller begin with equal bargaining power; in a racially divided market, the geographic level of competition affects this parity. The metropolitan scale of competition of the white market provides the buyer with a choice among neighborhoods, an implicit bargaining chip. The closed nature of the black market artificially funnels a buyer's decision to an intra-neighborhood level,

thereby generating a sellers' market. Not from any rational deliberation, but from race alone, the black buyer faces an economic predicament which forces him to do business with the ghetto expansionists or not at all. It is this strategically weakened position which allowed the ghetto speculator in Chicago to impose upon black consumers land installment contracts as the "price" of homeownership.

CONCEPTUALIZATION OF PRICE AND PROFIT IN THE INSTALLMENT CONTRACT MARKET

The study of price and profit relationships in the contract market is primarily a study of the price dynamics in racial transition neighborhoods. The price level at which units are shifted from the white market to the black market, and the existence of a premium, is a significant determinant of the level of prices in ghetto areas.[4] The short-term dynamics of racial transition are particularly significant in the ownership submarket because the price level affects the recapture of home equity by the departing white resident-seller and the long-term investment of the black buyer.

The most prominent characteristic of the contract system is the "inflated" nature of the contract purchase price compared to the white market price. Due to a real or artificially stimulated belief that prices will fall with black entry, or an increase in the supply of homes in anticipation of black entry (decreased white demand), speculators are able to purchase a unit at a depressed price in the white market and transfer it to the black market with a considerable markup. What factors determine gross markup and contract selling price? Is the arbitrage profit totally attributable to racial constraints on

access?

A beginning argument is that the white-black price comparison is one between two different housing bundles. The joint product of housing purchase and housing finance alters the standard conceptualization of price in the conventional cash (deed and mortgage) sale. In a contract sale price is more than a function of locational access, property and neighborhood characteristics. Regardless of the causative agent, when housing finance is a component of the legal purchase arrangement, price is additionally dependent upon the availability and cost of credit associated with that sale. There is no independent source of housing finance comparable to the mortgage loan.

The conjunction of housing purchase and finance means that the price -- purchase price and contract loan terms -- must cover the physical bundle of services, the time cost of deferred payment, and the probability that the buyer may fail to complete payment. Theoretically, the contract interest rate compensates the seller for financing the transaction, a portion of the interest rate for the declining value of future payment dollars, another for his capital investment. However, when the desired return exceeds the permissible contractual interest rate, the seller-lender must find a means to overcome mortgage usury ceilings. By charging finance points, fully payable at the time a loan is written, the mortgage lender increases the yield of the loan.[5] But in a contract sale, which is foremost a purchase by low-equity buyers possessing little additional cash for up-front financing charges, the alternative is to increase selling price so that the interest portion of the monthly payment on this inflated price repre-

sents a greater return than the contractual interest rate.[6] This method of recovery makes the finance premium proportional to the outstanding contract balance rather than a one-time charge.

Price in the contract market can be represented by the following relationship:

$$p_j^b = p_j^w (1 + \beta) \tag{4-1}$$

where

p_j^b = price in the contract market for housing type j

p_j^w = price in the cash market for housing type j

β = contract finance premium

β is a function of the probability of repayment as well as the opportunity cost of money.

In conventional housing finance markets, lenders use the equity requirement as a pricing parameter; the greater the perceived borrower risk, the greater the required downpayment, or else the interest rate or mortgage origination fee is adjusted to compensate the lender for the increased risk from a lower downpayment. But in the low-equity contract market, the contract seller usually cannot demand a higher downpayment and the usury ceiling commonly inhibits charging a contract interest rate commensurate with the perceived risks of low-equity finance. Contract downpayment, rarely an upwardly flexible price variable, is an asset measure of the borrower's ability to meet unexpected expenses and temporary income fluctuations. Change in the average downpayment over time reflects a change in the character

of credit demand in the contract market.

The dual housing market in Chicago was characterized by the use of a different set of instruments and institutions to support discriminatory activity. Discriminatory prices in the contract market resulted not from the above financing premium but rather from constraints on black access to the white market. The constraints enabled speculators to use the contract mechanism to charge a premium for transferring units from the white to black market. By eliminating independent lending activity, the contract sale allowed the speculator to misrepresent the value of the property. For example, although mortgaged at only \$8,000 - \$9,000, the property could have sold for approximately \$18,000 in the contract market. There was no appraisal process to provide the buyer with an independent assessment of market value. Furthermore, when contract buyers shopped and compared prices, they were comparing prices in a restricted market dominated by contract sellers.

Price in the black contract market includes an additional term, a discrimination premium:

$$p_j^b = p_j^w (1 + \beta) + \alpha_j \tag{4-2}$$

where

α = a discrimination premium for housing type j

The size of the discrimination premium depends upon the instruments available to control expansion of black residential areas and the organizational structure of the black market.[7]

The discrimination premium is theoretically independent of the finance markup; in the Chicago contract market this was not the case. Speculators' blockbusting activities, their collective control over transition properties and their exclusive use of land contract financing to secure the maximum profit left those buying in the transitional market little choice but to pay both the finance and discrimination markups.[8] Price determination in this market assumed contract financing regardless of a buyer's willingness or ability to buy on a cash basis. Sellers either refused to sell on a cash basis or to alter the price for cash sales.[9]

Because purchase price in the contract market included finance and discrimination components, there was a disparity between this price and the appraisal value of the property made by a mortgage lending institution. To compensate for a lower proposed loan-to-contract price ratio, the buyer in the contract market attempting to apply for a mortgage loan had to increase his downpayment to meet the requirements for this mortgage loan. This larger downpayment dramatically decreased the probability of a cash sale.

Arbitrage transactions in transitional neighborhoods result from a reluctance of white owners to deal directly with black households and institutional realty and credit constraints on direct access and purchase by black households. Restricted access increases the price of the unit in the black market. The arbitrage incentive is the difference between the acquisition price in the white market and the sale price in the black market. Contract speculators capture this dual market premium by transferring units between white and black

markets. The acquisition price and speculator profit can be written as follows:

$$p_j^s = (1 - \gamma)\ p_j^w \tag{4-3}$$

$$\Pi_j = p_j^b - (p_j^s + t_j) \tag{4-4}$$

where

p_j^s = acquisition price paid by speculator for housing type j

γ = acquisition discount

Π_j = net profit from sale for housing type j

t_j = transaction costs for housing type j

Excessively large profits may exist in the installment contract market for at least five, not mutually exclusive, reasons. The traditional explanation is that high returns represent a pure race premium ; speculators charge blacks more than they would charge whites because of discrimination. The second explanation focuses on "what the market will bear."

Speculators have done nothing irregular to affect the level of profits; anybody, even the white-resident seller, could earn the same profits in this market. The third explanation attributes the high returns to the financial nature of the real estate transaction. The speculator engages in an arbitrage process in which he buys a property for cash and sells it on a credit basis. The high return from such a transaction, spread out over time and characterized by uncertain profits, results from the costs of transferring units between credit markets.

The fourth explanation states that the high return compensates the speculator for the higher risks in a low-equity contract sale. The last explanation attributes high profits to a lack of competition in the contract market which allows speculators to earn monopoly profits.

The last argument, that contract sellers earn monopoly profits simply by furnishing a service otherwise unavailable in these early transitional neighborhoods, must be considered in light of the fact that contract sellers are not always passive participants. Speculators who blockbust aim at buying below fair market value through panic peddling and pressure tactics, selling high, and capitalizing on very high finance rates through the contract system.[10] Whether individual ghetto speculators create the transitional neighborhood through these blockbusting tactics is important in determining individual liability, in addition to understanding differences in the gross profits of operators in the contract market. However, whether a particular contract sale is the first black sale or the last black sale on the block would not affect the characteristics of economic behavior in the contract market. As long as excess demand exists in the black market and speculators act as intermediaries between the white seller and the black buyer, they earn "racially tinted" profits derived from restricted black access to the metropolitan housing market. The institutional factors responsible for the dual market are external to any one individual. Certainly a speculator can profit further to the extent he is able to initiate transition, or, for that matter, to mislead, conceal or defraud a buyer. However, these additional sources of profit result

from the particulars of individual transactions. The conceptual and empirical significance of an analysis of economic behavior in the contract market stems from the nature and organization of the market which generates a level of profit in excess of that which could be earned in the white market. It is the racial characteristic of the market, not the buyer, which is important.

Substituting equations (4-2) and (4-3) into (4-4), one can see that there are three parameters determining the speculator's profit : a contract finance premium, β; an acquisition discount, γ; and a discrimination coefficient, α .

$$\Pi_j = p_j^w (1+\beta) - (1-\gamma) p_j^w + \alpha_j - t_j \qquad (4-5)$$

This transaction price markup is the speculator's primary source of profit. The second source of profit in the installment contract sale comes from financing the purchase. It is the difference between the cost of financing the credit sale and the interest receipts of the installment sale. Since the basis for calculating interest on the installment sale differs from the speculator's property acquisition basis, interest profits are earned on the difference between these sums and from the difference between contract and mortgage interest rates.

Both the price markup and finance components of profit are earned over the term of the contract. To realize the return, the speculator typically holds the contract paper, leverages his position with a mortgage loan, and collects monthly payments over the term. From a cash flow perspective, the expected return, in nominal dollars,

is the difference between the contract payments and the speculator's mortgage finance obligations, minus administrative expenses.

$$\Pi_j = \sum_{n=1}^{t} (c_{jn} - (m_{jn} + a_{jn})) \qquad (4\text{-}6)$$

where

c_{jn} = contract payment for housing type j, period n

m_{jn} = mortgage payment for housing type j, period n

a_{jn} = administrative cost for housing type j, period n

t = term of contract

The present value of this income stream adjusts for the time value of money and provides a base for comparison with the profit from a deed and mortgage sale.

The primary analytical goal in this case study of the installment contract market is to empirically separate the conceptual components of consumer price and speculator profit to determine the size of the premium required to shift units from white to black market. A second goal is to determine whether the observed tight market structure affects price-setting behavior and expected profit. One can expect a discrimination premium as long as excess demand remains a characteristic of the market, but are these excess profits attributable to a lack of competition? Did the size of the contract arbitrage premium change over time? Did large-scale sellers earn higher profits and if so, were they able to sustain such profits over time? If contract selling was so profitable, why weren't there many more sellers? These are some of the important questions this chapter must address.

ANALYSIS OF PRICE AND PROFIT IN THE INSTALLMENT CONTRACT MARKET

The study of economic relationships in the installment contract market is primarily a study of the short-term dynamics of real estate transfers between racial submarkets. Almost 80 percent of the sample contract sales were located in neighborhoods experiencing the early stages of transition. For the seller, the contract represented a hedge against future rental price declines because it allowed him to lock in the short-term, neighborhood price surges associated with black residential expansion through the fixed-rate, long-term contract payment stream.

Most often price studies of racial transition have closely studied one neighborhood over time with detailed controls and documentation of price relationships before, during and after transition. In contrast, the data for analysis in this chapter covers paired transactions from white resident owner, to speculator, to black purchaser, across many transitional neighborhoods and over a thirteen-year period, 1956-1968. The breadth of this time period is justified by the early transition characteristic of the contract neighborhoods and the concentration of sales within a six-year period. Seventy-four percent of the transactions occurred between 1959 and 1965. The decision to pool the data reflects an assumption that the institutional characteristics which shaped the contract market did not change significantly during the thirteen years to alter the restrictions on direct accessibility confronting black households purchasing homes outside the established ghetto.[11]

The data set used for analysis in this chapter is composed of a sample of 565 installment contract transactions.[12] It covers 105 census tract neighborhoods with 88 percent of all sample sales occurring in 67 tracts, or 64 percent, of these neighborhoods. Fifty-eight percent of the properties are located in three west side communities: West Garfield Park, East Garfield Park, North Lawndale; an additional 30 percent, in three south side communities: Englewood, Greater Grand Crossing, West Englewood.

Data for individual transactions on the purchase price and terms of the installment sale, the characteristics of the property, and the acquisition costs and characteristics of the mortgage loan secured by the speculator was drawn from a number of original sources: installment contract and mortgage documents, property and fire insurance forms and appraisal reports. The acquisition price and cost data for this analysis, transcribed directly from the original sale documents and business records kept by the speculator, overcomes the common methodological problem of relying on revenue tax stamps.[13] Information on neighborhood (census tract) characteristics was drawn from the 1950, 1960 and 1970 U. S. Census of Population and Housing.

Transaction markups, shown in Tables 4-1 and 4-2, were extremely high. The average gross markup on a contract transaction exceeded 80 percent of the acquisition cost; after adjustments for the arbitrage transaction costs (which included mortgage fees), the net markup was just under 70 percent. Few if any improvements had been made on the properties between acquisition and resale.[14] Indeed, there was little time; the time lag between speculator purchase and resale, for those

TABLE 4-1

Mean Prices and Markups of Installment Contract Sales, 1956-1968

	Large-Scale Sellers	Small-Scale Sellers	West Side Submarket	South Side Submarket
Speculator acquisition price ($)	11,224	11,401	12,187	10,139
(constant dollars*)	(10,958)	(11,208)	(11,828)	(10,038)
Contract buyer purchase price ($)	19,756	19,573	20,609	18,197
(constant dollars*)	(19,153)	(18,999)	(19,966)	(17,687)
Gross markup (%)	83.9	81.6	76.9	91.1
New markup (%)	68.0	66.5	64.0	74.5
Gross cash investment ($)	23	388	300	-123
Price per room ($)				
Acquisition	1,105	1,023	1,051	1,126
Resale	1,949	1,726	1,771	2,046
Differential	859	742	744	945
Contract downpayment (%)	5.07	6.66	5.88	5.30
Number of observations+	353	212	350	215

* Constant dollars 1957-1959 = 100.

+ Number of observations may vary slightly for some variables.

TABLE 4-2

Mean Prices and Expected Profits on Installment Contract Sales Over Time, 1956-1968

	Time Frame			
	1956-1958	1959-1961	1962-1965	1966-1968
Speculator acqusition price ($)	10,793	11,866	11,474	8,448
(constant dollars*)	(11,075)	(11,593)	(11,069)	(7,991)
Contract buyer purchase price ($)	19,738	21,225	19,087	16,045
(constant dollars*)	(20,024)	(20,713)	(18,204)	(14,822)
Gross markup ($)	94.6	83.1	74.2	100.4
Net markup (%)	76.2	68.7	55.6	na
Gross cash investment by speculator ($)	388	527	-420	-279
Price per room ($)				
Acquisition	984	1093	1145	914
Resale	1866	1932	1869	1635
Differential	906	863	755	837
Contract downpayment (%)	8.60	5.60	4.53	3.86
Time lag between acquisition and resale (days, for properties sold within three months)	33	41	29	31
Monthly cash flow over term of contract ($)	56	50	38	41
Number of observations+	90	216	200	59
LIC sale within six months of acquisition and no prior contract sale				
Estimated expected present value net profit ($)	2,777	2,635	2,609	3,033
Estimated equity ($)	1,406	1,710	667	1,593
Present value price ($)	14,274	15,408	15,565	12,594
Number of observations+	54	142	85	9

* Constant dollars 1957-1959 = 100.
+ Number of observations may vary slightly for some variables.
na = information not available.

properties sold within three months, averaged 35 days.[15]

As expected, these markups varied among speculators, community areas, time periods, and type of housing. Based on the concentrated pattern of property ownership among a few large-scale speculators, particularly on the south side, one should not be surprised to find that these speculators charged the highest prices. Although the prices and expected profits of large-scale speculators were, on average, higher than those of small-scale speculators, the variances of these variables are substantial. Furthermore, there is no one-to-one correlation between market share and gross markup or profit. It appears that volume and property management strategy compensated for the variation in average profit.

The transaction markups are paper profits representative of the profits to be earned over the life of the contract. From an investment perspective, the present value of the expected net profit at the time of the contract sale presents a more accurate picture of the expected return.[16] This figure is a discounted estimate of total transaction profit over the life of the contract, <u>after equity recovery</u>, under the assumption that the buyer does not default. It is the difference between the present value of the contract payment stream (minus a five percent annual administration charge) and the present value of the seller's mortgage payment stream, minus the seller's initial cash investment. The seller's equity is the difference between total cash expenses (the sum of acquisition price, mortgage fees, legal fees, and estimated overhead expenses prior to resale and sales commission) and total cash intake (the sum of contract downpayment and first and second

mortgage loans) at the time of the contract sale (see Table 2-7). Because the estimate of the sales commission assumes that the commission was based on the face-value contract price, and paid at the time of the contract sale,[17] it may produce an overestimate of the speculator's equity in the transaction.

Utilizing a 15 percent discount rate, a figure not unrealistically high in this business sector,[18] the expected net profit from a transaction in which there was a positive equity averaged $2,211; the estimated equity, $2,165. The annual rate of return for these positive equity cases averaged 83 percent. The ability to secure a negative equity position dramatically increased the profitability of the transaction. For these transactions, the average expected net profit was almost twice as great as the former figure, $4,019; the annual net return, $511. The average negative equity was - $1,095. These expected profits were greatest for large-scale, west side sellers and south side properties. In light of the seller's relatively insignificant risk exposure and the high discount rate, these expected profits were very large.

Another way to evaluate the level of expected net profit is to calculate the hypothetical rate of return the seller would have received if, acting as a broker intermediary, he could have sold the property on a cash basis. This return is estimated by dividing the present value net profit by the sum of the acquisition and transaction costs. This hypothetical rate of return averaged 24 percent.

The evidence presented in Table 4-2 shows the market weakening during the 1960 decade but nonetheless capable of sustaining a high

level of profit. The contract purchase price, in constant 1957-1959 dollars, declined from a high of $20,713 during the peak of market activity to a low of $14,821 in the last significant phase of contract sales. Per room price respectively declined from $1,866 to $1,635. Contract downpayment, an asset barometer of buyer ability-to-afford homeownership, also decreased over time; in the early period of sales activity, between 1956 and 1958, speculators were able to take in an average downpayment of almost 9 percent compared to less than 4 percent in the 1966-1968 period. However, despite the decline in average markup, from a high of 95 percent in the early heightening period (1956-1958) to a low of 74 percent during the initial decline period (1962-1965), the present value of expected net profit remained relatively stable -- between $2,600 and $2,780.

The above relationships suggest that the stability of expected net profit was attributable to the ability of the speculator to secure favorable financing. As evidenced by the markup averages, the arbitrage profit from buying low and selling high was responsive to change in market demand and supply; if the speculator's mortgage leverage had remained constant over the time period, the expected net profit would have declined. But during this period the speculator's average equity decreased from a high of $1,710 during the peak of activity to a low of $667 in the next period as the corresponding average mortgage loan-to-price ratio increased to 97 percent from 87 percent.

In the installment contract market where profits are earned over the life of the contract, large profits are a function of early cash returns. The ability of the speculator to buy the property below fair

market value produces greater immediate returns than the high contract selling price because the mortgage loan based on the appraisal value, not the purchase price, often produces very high leverage for the speculator.

The Costs of Buying on an Installment Contract

About the only advantage the low-equity contract buyer receives over the average homebuyer who uses mortgage financing is the low move-in cost. This "savings" comes from the absence of numerous costs associated with closing a standard deed and mortgage transaction. These include fees for a title policy, a land survey, the document recording, escrow and appraisal services, a credit report, and possibly an attorney.[19] In 1960, the incidental costs of an FHA-insured mortgage on an existing home averaged $277, or 2 percent of the sale price.[20]

The higher costs of buying on contract are effectively hidden from the purchaser because they are built into an inflated purchase price. Unlike a cash (deed) transaction, in an installment contract, the buyer is jointly purchasing the property and credit; yet he believes he is buying a property with a value corresponding to the sale price.

What is the difference between the contract price and the hypothetical cash price, a variable we will call the credit arbitrage premium ? To derive an estimate of this variable it is necessary to calculate a cash price called the present value price (PVPRICE). This hypothetical figure is an estimate of the price a seller would be willing to accept for a cash transaction assuming he discounts the

time value of money for the contract transaction at 15 percent. According to the definition:

PVPRICE = SPURCHP + TRANS + PVNETPR (4-7)

where

SPURCHP = acquisition price paid by the speculator

TRANS = transaction costs associated with cash sale (sales commission, overhead, legal fees)

PVNETPR = present value of the expected net profits from the contract transaction payment stream discounted at 15 percent

A deed sale at the PVPRICE would provide a return equivalent to the expected present value net profit of the installment contract transaction.

The difference between this PVPRICE and the contract price, the credit arbitrage premium, measures the extra cost incurred by the contract buyer to transfer units to the black market through the contract sale mechanism given the organization of the local housing market.

While the PVPRICE adjusts for the time value of money, it does not adjust for the risks of contract nonpayment which vary with individual borrower characteristics. Speculators need not discount the payment stream at 15 percent and the discount rate may vary among speculators. Because of these factors, the credit arbitrage premium may contain part of the premium attached to certain housing attributes unavailable in the ghetto, in addition to the expected price adjustment for the risk of buyer forfeiture.

The average credit premium, $5,541, or 27 percent of the contract sales price, varied substantially over a number of different market characteristics as shown in Table 4-3. It varied inversely with the amount of buyer downpayment; for buyers with zero donwpayment, $6,201, while for those with the highest downpayments (12 percent or more), $4,439. Looking at the average premium across neighborhoods classified by the stage of racial transition, we see that it was highest for those neighborhoods in early transition, $7,150 and $5,419, and lowest for those properties in consolidation and late consolidation neighborhoods, $5,020, and $4,064.

This arbitrage premium is not a complete measure of the discriminatory burden of the transaction. Part of the arbitrage profit arises from the difference between the panic-free white market price and the depressed price at which the speculator generally acquired property from distressed white sellers. The hypothetical cash price includes this first component of profit. The second part of the profit is a capitalized financing and holding cost levied by the speculator for the long-term purchase arrangement. To the extent that the contract price exceeds the price of purchase in a white market free of pressure-selling tactics (i.e., FHA appraised value), a discriminatory premium exists in both the PVNETPR and the credit arbitrage component.

The conjunction of black buyers with low equities makes it empirically difficult to isolate the component of contract price which adjusts for the risk of nonpayment from the component which represents a race premium. An independent race premium could not be isolated without a sample of white buyers who bought on installment

TABLE 4-3

Mean and Standard Deviation of Credit Arbitrage Premium for Selected Stratifications

Stratification	Premium ($)	Standard Deviation ($)	As a Percent of Contract Sales Price	Standard Deviation	n
All observations	5367	1737	27.0	6.3	290
Submarket					
West side	5670	1791	27.3	6.0	193
South side	4765	1455	26.3	6.8	97
Time Period					
1956-1958	5381	1449	28.0	6.4	54
1959-1961	5835	1831	28.1	5.9	142
1962-1965	4630	1295	24.1	5.3	85
1966-1968	4870	2915	30.0	10.5	9
Contract Downpayment (%)					
0	6201	3043	34.6	14.7	4
0-2.99	5972	1894	30.3	5.5	27
3-5.99	5261	1621	27.2	5.4	136
6-8.99	5541	1803	27.4	6.1	83
9-11.99	5060	1600	23.9	6.2	28
12 +	4439	1674	19.2	5.4	12
Stage of Racial Transition					
Penetration	7150	1245	29.7	3.9	13
Invasion	5419	1663	26.8	6.4	198
Early Consolidation	5316	1837	29.1	5.3	16
Consolidation	5020	1793	26.1	5.6	50
Late Consolidation	4064	1707	28.1	9.7	12
Piling Up	5725	--	28.9	--	1
Scale of Speculator					
Large	5319	1631	26.7	6.1	199
Small	5472	1954	27.6	6.6	91

contract in white neighborhoods. Yet the fact that blacks had little choice but to buy on contract in these transitional neighborhoods is a critical component of the race premium blacks paid to transfer units to the black market.

Determinants of the Credit Arbitrage Premium

This section utilizes an ordinary least squares regression model to explain variation in the credit arbitrage premium for each geographic submarket of the black ghetto of Chicago. It is necessary to stratify the sample in this manner because of the different organizational structures of each submarket and its hypothesized effect upon economic behavior.

The model was formulated upon the conception that the credit premium is determined by two elements: (1) the variance in expected return from the transaction, a function of the probability of buyer forfeiture; and (2) the excess demand for housing bundle attributes in short supply in existing black neighborhoods.

The variance in the expected profit of the transaction is a function of uncertainty, the risk that the buyer will default on the contract. Features of the installment contract determining the amortization rate of the payment schedule, and the characteristics of the borrower and the neighborhood which affect the likelihood of default are expected to be significant determinants of the credit premium. These variables include contract term, contract downpayment, borrower monthly payment burden, and as a proxy for neighborhood risk, a set of dummy variables measuring the extent of substandard housing in the neighborhood. The measure of borrower income used in the payment

burden variable is the 1960 median income for families in 1957-1959 constant dollars.

Five variables, 1960 median value of owner-occupied single-family units in constant dollars (MD60), two dummy variables denoting stage of racial transition of the neighborhood (ET, LT, proxies for "better" neighborhoods), type of structure (BLD), and number of apartments in the structure (NAPTATP) have been included to explain variation attributable to characteristics of the housing bundle in short supply in existing black neighborhoods. A dummy variable indicating the scale of the operations of the speculator (LS or CANDG) has been included to test for the possibility of differential speculator pricing behavior. The model is completed with a series of dummy variables which define the time period of the sale. The definitions, means and standard deviations of these 14 variables are presented in Tables 4-4 and 4-5.

In the linear form the credit premium is viewed as an additive composite of the individual variables; the estimated relationship[21] may be written:

$$\begin{aligned} CREDPREM = {} & a + b_1 BLD + b_2 NAPTATP + b_3 MD60 + b_4 SUB1 + b_5 SUB3 \\ & + b_6 ET + b_7 LT + b_8 LS + b_9 BURDEN + b_{10} KDP \\ & + b_{11} KTERM + b_{12} TIME2 + b_{13} TIME3 + b_{14} TIME4 \qquad (4\text{-}8) \end{aligned}$$

The primary focus of this model is on the coefficients of the risk variables which measure the marginal effect of a change in a credit characteristic upon the credit arbitrage premium.

The estimated models presented in Table 4-6 explain substantial proportions of the variation in the arbitrage premium and the F-tests

TABLE 4-4

Definition of Variables in the Credit Arbitrage Model

Variable	Definition
CREDPREM	The difference between contract sale price and a hypothetical cash price; measures the extra cost incurred by the contract purchase as opposed to a deed and mortgage purchase.
BURDEN	Ratio of monthly contract payment to family income. 1960 census tract income, 1957-59 constant dollars as proxy for family income.
KDP	Percent contract downpayment.
KTERM	Term-to-maturity of contract, years.
SUB1	Dummy variable. 1 = less than 10 percent of housing units in census tract substandard; 0 = otherwise (1960).
SUB3	Dummy variable. 1 = more than 20 percent of housing units in census tract substandard; 0 = otherwise (1960).
	The excluded category for substandard housing is 10 - 20 percent.
MD60	1960 median value of owner-occupied units in census tract in 1957-59 constant dollars.
ET	Dummy variable. 1 = neighborhood in early stage of racial transition (Penetration, Invasion); 0 = otherwise.
LT	Dummy variable. 1 = neighborhood in late stage of racial transition (Late Consolidation, Piling Up); 0 = otherwise.
	The exclused category is neighborhood in intermediate stage of racial transition (Early Consolidation, Consolidation).
BLD	Dummy variable. 1 = multi-flat (2 - 4 flat) structure; 0 = single-family structure.
NAPTATP	Number of apartments in structure at time of the contract sale.
LS	Dummy variable. 1 = large-scale seller in west side market; 0 = small-scale seller in west side market.
CANDG	Dummy variable. 1 = large-scale seller , Peck or Master, south side market; 0 = other large-scale seller and all small-scale speculators in south side market.
TIME2	Dummy variable. 1 = sale occurred between 1959 - 1961; 0 = otherwise.
TIME3	Dummy variable. 1 = sale occurred between 1962 - 1965; 0 = otherwise.
TIME4	Dummy variable. 1 = sale occurred between 1966 - 1968; 0 = otherwise.
	Excluded time category is 1956 - 1958.

TABLE 4-5

Means and Standard Deviations of Variables in the Credit Arbitrage Premium Regression Model

Variable	West Side Submarket		South Side Submarket	
	Mean	Standard Deviation	Mean	Standard Deviation
CREDPREM ($)	5,673	1,782	4,775	1,467
Risk-related Characteristics				
BURDEN (%)	35.25	8.08	31.90	10.94
KDP (%)	6.01	3.28	6.15	3.31
KTERM (years)	18.34	4.46	16.15	3.10
SUB1 (yes = 1)	.70	--	.51	--
SUB3 (yes = 1)	.19	--	.19	--
Neighborhood and Building Characteristics				
MD60 (hund. dol.)	137.72	22.37	136.60	21.71
ET (yes = 1)	.78	--	.62	--
LT (yes = 1)	.04	--	.07	--
BLD (multi-flat = 1)	.86	--	.53	--
NAPTATP	1.36	0.93	.95	1.07
Other Variables				
LS/CANDG (yes = 1)	.62	--	.65	--
TIME2 (yes = 1)	.48	--	.51	--
TIME3 (yes = 1)	.37	--	.15	--
TIME4 (yes = 1)	.02	--	.04	--
Number of observations	189		95	

TABLE 4-6

OLS Regression Model of the Credit Arbitrage Premium

Independent Variable	West Side Submarket		South Side Submarket	
	Coefficient	(t-value)	Coefficient	(t-value)
Risk-Related Characteristics				
BURDEN (%)	96.31[a]	(7.56)	46.81[a]	(2.53)
KDP (%)	-94.76[a]	(-3.95)	-27.69	(-0.62)
KTERM (years)	226.51[a]	(13.15)	203.21[a]	(4.85)
SUB1	-379.24	(-1.47)	147.16	(0.55)
SUB3	-526.97	(-1.80)	-186.66	(-0.52)
Neighborhood and Building Characteristics				
MD60 (hund. dol.)	0.77	(0.24)	12.65	(2.07)
ET	596.16[b]	(3.03)	-45.66	(-0.19)
LT	-108.36	(-0.23)	-498.66	(-0.99)
BLD	382.69	(1.47)	65.82	(0.22)
NAPTATP	-33.77	(-0.33)	203.12	(1.10)
Other Characteristics				
LS/CANDG	-263.89	(-1.76)	-72.43	(-0.26)
TIME2	-441.48	(-1.94)	-513.20	(-1.91)
TIME3	-1,668.37	(-7.09)	-970.95	(-2.34)
TIME4	-1,508.89	(-2.80)	990.43	(1.43)
Intercept	-762.76	(-1.03)	-1,517.54	(-1.25)
DF	174		80	
R^2	.755		.597	
F Ratio	38.26		8.46	
Prob > F	.0001		.0001	

NOTE: Table notes significance of t-ratios for four coefficients under simultaneous statistical testing for overall level of significance (BURDEN, KDP, KTERM, ET).

a. .05, one-tailed test

b. .05, two-tailed test

prove that the model is statistically significant at the 95 percent level of confidence. Most importantly, all of the risk-related variables, except the dummy variable measuring the high proportion of neighborhood substandard housing,[22] display the expected coefficient sign.

As expected, increasing the term-to-maturity of the contract one additional year boosted the credit premium, $227 and $203, respectively in the west and south side markets. The coefficients of the downpayment and burden variables indicate that the west side market was more responsive to changes in buyer risk characteristics. A one percent increase in contract downpayment decreased the credit premium by $95 in the west side market, compared to $30 in the south side market, ceteris paribus. An increase of one percent in the buyer payment-to-income ratio increased the credit premium by $96 in the west side market, compared to $47 in the south side market. These findings are consistent with the lack of price bargaining noted by at least one large-scale, south side speculator during the trial proceedings.[23]

The marginal price effects from changes in borrower-risk variables are small compared to the neighborhood effects.[24] Buying in early transition tracts on the west side added almost $600 to the arbitrage premium, compared to an equivalent transaction in clearly established black neighborhoods (classified as consolidation or early consolidation stage).[25] On the south side, where contract properties, classified by stage of transition, were more evenly distributed, there was no statistically significant finding of a additional premium in

early transition neighborhoods.

If the early transitional variable is a proxy for a "better" neighborhood, the south side model suggests that such quality distinctions may not be unimportant, but that the transition stage variable is not capturing the distinctions. An indication of the effects of neighborhood quality can be gleaned from the small but important marginal effect on the credit premium from a change in the neighborhood median value of owner-occupied units.[26] (See Appendix Table 1, for the standardized coefficients.)

Despite the difference in arbitrage pricing between these submarkets, they were bound by a common trend, the decline in the size of the credit arbitrage premium over time. Looking at the changes implied by the time dummy variables, we see that after the early period of contract sales, 1956-1958, speculators were unable to continue charging the highest contract credit premiums to transfer units between the white and black markets (except in period 4). For a contract transaction on a two-flat building in an early transition neighborhood, of average-valued homes and substandard housing for this sample, where the buyer had put down 5 percent and signed a contract of 18 years, which committed him to a monthly payment burden of 33 percent of family income, the credit arbitrage premium varied over time in the following manner:

	West Side Submarket	South Side Submarket
Time Period 1: 1956-1958	$6,805	$5,418
Time Period 2: 1959-1961	6,363	4,904
Time Period 3: 1962-1965	5,136	4,447
Time Period 4: 1966-1968	5,296	6,408

A Note on the Pricing of Large-Scale Speculators

Given the predominant position of large-scale sellers in both submarkets, one would expect them to charge higher prices, *certeris paribus*. The results of the regression model of installment contract price, presented in Appendix Table 4, indicate that in the south side market, where there were few competitors, the price increment attributable to the large-scale speculator was large and statistically significant. By contrast, the scale premium on properties sold by large-scale speculators in the west side market, where there were numerous competitors, was insignificant and small, $213, compared to $2,651 in the south side market. This is important because it affirms the beneficial role of internal competition despite the restricted nature of the black market.

Determinants of Profit within the Installment Contract Market

Profit in the contract market is derived from two sources: the difference between acquisition costs and sale price, plus the return from financing the sale. The deferred profit and contract interest rate are the gross indicators of these components but each is not necessarily a reliable guide to net profit. A return from the finance component comes from two sources: the difference between the contract price and the seller's investment finance (mortgage loan), and the difference between the interest rates of these arrangements. To the extent that the seller expects the risks of financing the buyer's purchase to exceed the interest rate differential, he will discount the profits from the sale component. Secondly, the seller secures the joint return through a monthly cash flow stream over the term of the

contract, similar to the way rental profit accrues. While the difference between the present value of the payment stream discounted at the respective mortgage and contract interest rates, in theory, equals the deferred profit, the seller has increased the contract sale price to compensate for the uncertainty of return and really may not expect to realize the paper deferred profit figure. He may sell the contract paper after a few years. Or, if he holds the paper to term, contract payment delinquencies may alter the profit stream. Furthermore, the ability of the speculator to begin the repayment period with a negative equity suggests that the actual earned profit may not equal the observed paper profit.

One would of course like to know the extent to which profits in the contract market exceeded those obtainable in an open market. Given the fact that the sample data only consists of black purchases on installment contracts, the average profit figure cannot be compared to a profit figure for installment sales made in white neighborhoods. One standard for evaluating the estimated returns obtainable in the contract market comes from a group of contract sales made to whites in the township of Broadview, a suburb of Cook County near the west side boundary of Chicago. These seven sales, made by the largest south side speculator, were similar to the black contract sales in two respects: the low percentage downpayment (lower than the black market average), and the high mortgage-to-purchase price ratio of the speculator's loan. However, the average markup differed considerably. 16 percent compared to an average 91 percent for this speculator's black contract sales.

This section focuses upon an analysis of the internal determinants of profit in the contract market in an effort to isolate the hypothesized dominant role of mortgage finance. In so doing, it addresses three additional questions: Were neighborhood risk factors capitalized into higher profit calculations? Did internal competition inhibit large-scale sellers from earning higher profits? Did expected profit decline over time?

To answer these questions, an ordinary least squares regression model explaining expected net profit at the time of the contract sale has been estimated. The model uses the estimated present value net profit variable (PVNETPR) as the dependent variable. The PVNETPR figure represents the discounted net return the speculator could expect from the completed transaction at the time the installment contract was signed. It simplifies the analysis by abstracting from the time value of money and accounts for potential slowness in the contract payment stream through the use of the 15 percent discount rate. Transactions involving properties where there had been prior contract sales or which had been used for more than six months as a source of rental income were excluded from this analysis.

Expected net profit is viewed as a function of the characteristics of the seller's mortgage financing, type of structure, neighborhood housing stock attributes and stage of racial transition, and speculator scale. Equity is obviously a predominant determinant of net profits; however, its direct inclusion in the model would not provide an understanding of the role of its individual components in determining profit. Therefore, the following variables have been

included to describe the equity position of the seller: the loan-to-purchase price ratio (MTGLVR), a dummy variable indicating the existence of a second mortgage (SECMTG), a dummy variable indicating whether the seller had a negative equity position (NEGEQ), and the percent contract downpayment (KDP). All are expected to have a positive effect on the level of expected profits. The importance of the mortgage loan-to-purchase ratio goes beyond the obvious leverage function because it picks up the effects attributable to the ability of the speculator to purchase at a depressed white market price. Given the nature of the institutional mortgage arrangements, it also picks up the value of over-appraisals. In the absence of an independent assessment or FHA-appraised value, there is no way to distinguish these two occurrences.

Three variables proxy the neighborhood characteristics of the housing stock: the two substandard housing dummy variables utilized in previous analyses, SUB1 and SUB3, and the 1960 median value of owner-occupied, single-unit buildings in constant dollars (MD60). The hypothesis is that net present value profit is higher in neighborhoods with poorer housing stocks and reflects a capitalization of neighborhood risk factors independent of the credit characteristics of the individual borrower. The same effect is hypothesized with regard to the late transition neighborhood variable (LT). Higher profits in early transition neighborhoods compared to those in the intermediate stages of transition are also expected due to the higher contract prices in these neighborhoods. However, the direction of causation is unclear because speculators may incur higher acquisi-

tion costs in the early transition neighborhoods.

The model also includes a dummy variable for the type of structure, whether single-unit or multi-flat, to test for a higher expected profit attached to an income-producing unit (BLD). The speculator scale variable, LS for the west side and CANDG for the south side, has been included to test for hypothesized higher returns earned by large-scale speculators. To complete the model, the three dummy variables for time have been included.

The definitions, means and standard deviations of these 14 variables are presented in Tables 4-7 and 4-8.

The estimated expected profit model may be written:[27]

$$\begin{aligned} PVNETPR = a &+ b_1 MTGLVR + b_2 NEGEQ + b_3 SECMTG + b_4 KDP \\ &+ b_5 SUB1 + b_6 SUB3 + b_7 MD60 + b_8 BLD + b_9 ET \\ &+ b_{10} LT + b_{11} LS + b_{12} TIME2 + b_{13} TIME3 + b_{14} TIME4 \end{aligned} \quad (4\text{-}12)$$

The estimated model for each submarket is presented in Table 4-9; the F test for each proves that the joint relationship of all variables in the model is statistically significant at the 95 percent level of confidence.

The importance of mortgage finance is clearly shown in these equations. The difference between a conventional first mortgage MTGLVR of 70 percent and the average MTGLVR of 90 percent secured by the contract speculator increased the present value profits by an estimated $623 in the west side market and $938 in the south side market. The profit-financing elasticity evaluated at the mean is 1.21

TABLE 4-7

Definition of Variables in Present Value Net Profit Model

Variable	Definition
PVNETPR	Present value of net profit of contract sale calculated at the time of contract sale closing.
MTGLVR	Mortgage loan-to-purchase price ratio (percent).
NEGEQ	Dummy variable. 1 = seller has negative equity position in contract transaction; 0 = otherwise.
SECMTG	Dummy variable. 1 = seller obtained second mortgage on contract property within one year of purchase; 0 = otherwise.
KDP	Percent contract downpayment.
SUB1	Dummy variable. 1 = less than 10 percent substandard housing units in census tract; 0 = otherwise.
SUB3	Dummy variable. 1 = more than 20 percent substandard housing units in census tract; 0 = otherwise.
	The excluded category for substandard housing is 10 - 20 percent.
MD60	1960 median dollar value of owner-occupied units in census tract in 1957-59 constant dollars.
BLD	Dummy variable. 1 = multi-flat structure; 0 = single-family structure.
ET	Dummy variable. 1 = neighborhood in early stage of racial transition (Penetration, Invasion); 0 = otherwise.
LT	Dummy variable. 1 = neighborhood in late stage of racial transition (Late Consolidation, Piling Up); 0 = otherwise.
	The excluded category is neighborhood in intermediate stage of racial transition (Early Consolidation, Consolidation).
LS	Dummy variable. 1 = large-scale seller in west side market; 0 = small-scale seller in west side market.
CANDG	Dummy variable. 1 = large-scale seller, Peck or Master, south side market; 0 = other large-scale seller and all small-scale sellers in south side market.
TIME2	Dummy variable. 1 = sale occurred between 1959-1961; 0 = otherwise.
TIME3	Dummy variable. 1 = sale occurred between 1962-1965; 0 = otherwise.
TIME4	Dummy variable. 1 = sale occurred between 1966-1968; 0 = otherwise.
	Excluded time category is 1956-1958.

TABLE 4-8

Means and Standard Deviations of Variables in the Present Value Net Profit Regression Model

Variable	West Side Submarket		South Side Submarket	
	Mean	Standard Deviation	Mean	Standard Deviation
PVNETPR ($)	2,574.08	1,363.57	3,159.69	1,615.96
Equity Characteristics				
MTGLVR	90.51	16.89	91.46	22.05
NEGEQ (yes = 1)	.22	--	.35	--
SECMTG (yes = 1)	.07	--	.22	--
KDP	6.12	3.30	6.16	3.25
Neighborhood Characteristics				
SUB1 (yes = 1)	.70	--	.52	--
SUB3 (yes = 1)	.19	--	.17	--
MD60 (hundred dollars)	137.54	22.62	136.69	21.91
ET1 (yes = 1)	.78	--	.63	--
LT (yes = 1)	.03	--	.06	--
Other Characteristics				
BLD (yes = 1)	.85	--	.54	--
LS (yes = 1)	.63	--	CANDG .65	--
TIME2 (yes = 1)	.49	--	.52	--
TIME3 (yes = 1)	.36	--	.15	--
TIME4 (yes = 1)	.02	--	.03	--
number of observations	181		93	

TABLE 4-9

OLS Regression Model of Present Value Net Profit

Independent Variable	West Side Submarket		South Side Submarket	
	Coefficient	(t-value)	Coefficient	(t-value)
Equity Characteristics				
MTGLVR (%)	31.15	(4.18)[a]	46.89	(4.75)[a]
NEGEQ	1,196.44	(4.46)[a]	-317.33	(-0.75)
SECMTG	716.84	(2.25)	693.15	(1.75)
KDP (%)	6.99	(0.27)	121.30	(2.36)[a]
Neighborhood Characteristics				
SUB1	-157.99	(-0.56)	-158.94	(-0.46)
SUB3	284.06	(0.89)	390.91	(0.89)
MD60 (hundred dollars)	-10.91	(-3.00)	3.09	(0.38)
ET	170.69	(0.75)	209.02	(0.64)
LT	384.69	(0.77)	100.71	(0.15)
Other Characteristics				
BLD	675.30	(3.00)	322.76	(1.03)
LS/CANDG	302.13	(1.78)	-589.12	(-1.63)
TIME2	-541.56	(-2.24)	7.38	(0.02)
TIME3	-772.17	(-2.77)	61.24	(0.11)
TIME4	-375.91	(-0.64)	1,904.24	(2.11)
Intercept	591.72	(0.65)	-2,327.09	(-1.57)
Degrees of Freedom	166		78	
R^2	.507		.458	
F Ratio	12.17		4.71	
Prob > F	.0001		.0001	

NOTE: Table notes indicate significance of t-values for five coefficients under simultaneous statistical testing for overall level of significance (MTGLVR, NEGEQ, KDP, SUB3, LS).
a. .05 one-tailed test
b. .10 two-tailed test

and 1.48, respectively, for the west and south side submarkets. The increase in profits resulting from second mortgage financing was approximately the same in both submarkets, an additional $700 in present value profits. While the use of second mortgages was not commonplace, it was characteristic of several large-scale speculators; Boston, Peck, and Master had second mortgages on 38, 23 and 27 percent of their respective sample transactions.

The ability of west side speculators to operate with a negative equity position was a significant factor explaining expected net profits; this characteristic increased the expected profit, on the average, $1,196. This is quite significant in light of the predominant role savings and loan associations played as financiers of over-appraised mortgage loans in the west side market. The standardized b-value also reveals the greater relative importance of this variable for the west side (Appendix Table 5). The incorrect sign and insignificance of the NEGEQ variable in the south side equation can be attributed to modest multicollinearity between this variable and MTGLVR.[28] It should be remembered that MTGLVR is a measure of the leverage from first mortgage financing and NEGEQ measures negative equity resulting from the net difference between total cash intake and total cash expenditures. The conceptual importance of NEGEQ necessitates its retention in the model; to omit it would result in bias in the MTGLVR coefficient.[29]

Another major difference in market behavior between the west and south sides is seen in the contribution of contract downpayment toward expected profits. Evaluated at the mean downpayment, which is

approximately 6 percent for both submarkets, an increase of one percent would have led to a .27 percent increase in profits in the west side market, compared to 3.8 percent in the south side market. Although mortgage finance and contract downpayment both increased profits by maximizing early returns, the importance of financing in the west side market minimized the downpayment contribution.

Given the large standard estimates of error and low t-values for the neighborhood variables, these coefficients should be interpreted to be merely suggestive of the real relationships. The sign of the high neighborhood substandard housing variable indicates that speculators aimed for higher returns in these neighborhoods to compensate for greater uncertainty in areas where the risks of property deterioration were greater, other factors held constant. The fact that contract prices were on average lower in late transition neighborhoods suggests that the expected higher profits came from lower acquisition costs. Conversely, higher contract prices in early transition neighborhoods and neighborhoods where the incidence of standard housing is less than 10 percent suggest that the lower expected profits came from higher acquisition costs than in established black neighborhoods.

The additional findings from the model emphasize the differences between west and south side markets. A contract sale of a multi-flat building was expected to yield a higher return than a single-unit building, but there was no significant difference on the south side where the number of single units was proportionately greater. The most important differences involve the higher expected profits earned by west side large-scale sellers (despite the lack of evidence of higher

prices in the contract price model). The incorrect sign for this factor in the south side market is hard to understand.

Although both markets experienced a noteable decline in the expected present value net profit over the three periods of major contract activity, this decline was largest in the west side market. Expected present value net profit from a basic transaction in which the buyer had put down 6 percent on a two-flat building in an early transition neighborhood, where the stock contained less than 10 percent substandard housing and the median value of owner-occupied homes was $13,700, and where the large-scale speculator had secured 90 percent first mortgage financing with no second mortgage (resulting in a positive equity position), varied as follows:

	West Side Submarket	South Side Submarket
Time Period 1: 1956-1958	$2,933	$2,828
Time Period 2: 1959-1961	2,391	2,835
Time Period 3: 1962-1965	2,160	2,318
Time Period 4: 1966-1968	2,557	4,732

The fourth period of contract market activity deviated from the decline pattern; there was an increase in markups and expected profits which can be attributed to several factors. During this period a number of sellers had dropped out of the market, which decreased the level of competition. Secondly, the increase in markups and profit expectations may have reflected an awareness of a weakening market and a lower probability of holding the contract to term. Hence an increased capitalization of finance and holding costs would lead to higher prices and higher expected profits.

Price and profit relationships in the installment contract market reflected a complex interaction of factors: the lack of mortgage money in transitional neighborhoods, the low-equity position of the average contract buyer and the "risks" of repayment, and the relationship of the supply of housing units in these transitional neighborhoods to movements in the larger metropolitan housing market. The latter factor historically has had an important impact on the aggregate supply of units in transitional neighborhoods in Chicago. Over time this supply has been related to the scale and pace of new suburban construction.[30] To leave a neighborhood, whites must have other neighborhoods to move to.[31] In the absence of a fluid supply in the white market or an ability to buy into a new neighborhood, whites steadfastly, and sometimes violently, guard their turf. Speculators generally skip over these pockets of housing because the total costs of acquiring such units are higher, the profits lower, and blacks on the average are not interested in incurring the additional psychological costs of moving into such neighborhoods.[32]

Over time, the price relationships in the contract market reflected the increased supply of units in older white neighborhoods. While prices and markups declined, the profit from arbitraging the differences between white and black markets nevertheless remained high, due to the favorable financing terms speculators were able to secure from institutional mortgage lenders.

This chapter has advanced the hypothesis that blacks in transitional neighborhoods pay a discrimination premium to transfer units between white and black housing markets. Part of this premium is

attributable to the segregated structure of the metropolitan housing market, to the gap between the price in the white border market and the price the black market "will bear". The other component of the premium is attributable to the nature of the finance instrument involved in the transaction -- the installment sales contract.

The analysis of contract prices and profits in this chapter provides an estimate of the jointly determined premium for the black contract market in Chicago between 1956-1965. Although theoretically independent, in the black market the finance and discrimination components were interrelated. Therefore, two estimates are presented, one for the hypothetical "cash" transaction which is a lower bound estimate, and one for the contract transaction which is an upper bound estimate.

TABLE 4-10

"Cash" and Contract Price Averages of the White-Black Market Transfer Premium, for Penetration and Invasion Stage Neighborhoods by Submarket, 1956-1968

	"Cash" Price Premium	Percent Net Markup	Contract Price Premium	Percent Net Markup
West Side Market				
Penetration (n = 13)	$2,842	19.8	$9,596	70.3
Invasion (n = 139)	2,316	18.7	7,291	60.7
South Side Market				
Invasion (n = 63)	3,125	30.3	7,201	73.0

The lower bound estimate is the difference between the hypothetical cash price the speculator would accept in the black market (assuming a 15 percent discount rate) and his acquisition costs; this is

the estimate of the present value of the expected net profits (PVNETPR). The upper estimate is the difference between the contract price and the speculator's acquisition and finance costs. (The difference between these two estimates represents the credit arbitrage premium plus fees paid by the speculator for mortgage finance.) While the credit arbitrage premium has been shown to be a function of borrower risk characteristics and contract credit terms, risk of repayment is a small factor explaining the difference between "cash" and contract prices.

This distinction between "cash" and contract price premiums is useful for understanding the extra costs of contract buying, but, nonetheless, it is an artificial distinction. Buyers did not have the "cash" option. Speculators in the contract market had one price, the contract price. While speculators relied on the risk argument to justify the large disparity between acquisition and resale prices, they also, paradoxically, stated that the price would not change for a cash sale.[33] Indeed, one speculator who now sells on FHA says he gets "the same price, or more, in many cases than...on contract."[34]

The market price charged by speculators was a black market price; all buyers in this market were considered as a class, a type of buyer, black. Price variations due to individual borrower risk characteristics were minor. Given the price and profit relationships in the black contract market and the protection the contract sale offered the seller, the risk argument appears weak. How weak? How risky were these transactions? Chapter 5 addresses these questions.

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(Pgs. 191-199)

CHAPTER 5

The Nature and Extent of Risk in the Installment Contract Market

And if Purchaser fails, and if said default shall continue for a period of more than thirty days, to make any of the payments... this contract shall, at the option of the Seller, be forfeited... and the Purchaser shall forfeit all payments made on this contract, and such payments shall be retained by the said Seller in full satisfaction and as liquidated damages...and in such event the Seller shall have the right to re-enter and take full possession of the premises aforesaid.

Articles of Agreement for Deed Installment Contract As Revised May 1954 by Crane & Goran.

The land installment sales contract has traditionally functioned as the legitimate financing instrument of the low-equity homebuying sector. The scope of this sector has historically covered the inverse of what institutional lenders considered "safely mortgageable". Prior to the emergence of the FHA, which stimulated the acceptance of liberal loan terms, installment contracts were often utilized as short-term purchase instruments with a provision for conversion to mortgage finance when the paid-up principal reached 40 or 50 percent, the conventional downpayment required by institutional lenders in the early part of the twentieth century.

If black contract purchases had occurred in an open market, free of racial barriers, a buyer might have been able to secure conventional financing after a few years of contract payments, or at least after his "equity" matched the contractural mortgage conversion point and he had proven himself a reasonable risk. Yet prior to 1966, few purchasers were able to do so.[1]

The conjunction of below-average income borrowers and racial discrimination poses difficulties in separating the effects of discrimination from the evaluation of risk in housing finance markets.

In particular it poses an ambiguity regarding the "credit-worthiness" of contract buyers. On the basis of which price does one evaluate the contract buyer's downpayment -- the inflated contract price or a fair market cash price? In the absence of racial discrimination, would these buyers have qualified for FHA-insured or VA-guaranteed mortgage loans, or did they represent a separate risk cohort?

Because land contracts and mortgages are characterized by different risk parameters, and price relationships in the contract market distort buyer purchasing power, these questions cannot be answered directly.

The purpose of this chapter is to delineate differences in these risk characteristics and explain how they affect the behavior of contract seller and buyer. The discussion then turns to empirical evidence of repayment experience in the contract market. The high risk of low-equity finance repeatedly cited by both contract sellers and institutional lenders stands as the primary explanation for their respective behavior in this market. Just how prevalent was contract default and forfeiture? To what extent did forfeiture result from individualistic management policies? What characteristics of the buyer and the neighborhood are correlated with payment delinquency and forfeiture? How do these factors compare with conventional predictors?

If contract buyers successfully coped with higher carrying charges under contract financing than required with mortgage financing, the case study provides evidence that the economic risks of lending in transitional neighborhoods have been distorted by specu-

lative contract sales activity.

> How can a black buyer who pays from $130-$165 a month to a speculator be a poor credit risk at $90 to $100 for a house with a legitimate mortgage at a fair market price?[2]

RISK IN RESIDENTIAL FINANCE MARKETS

Risk in Mortgage Markets

A mortgage under Illinois law is an interest in land given as security, usually in return for a loan of money. The borrower secures cash by selling, and the lender by buying, a future set of payments. The party who gives the mortgage (mortgagor) and receives the loan usually retains title to the property "subject" to the mortgage. The lender (mortgagee) has a lien against the property which he may enforce by invoking Illinois foreclosure and sale statutes if the mortgagor defaults.[3]

An investor lending funds on a mortgage faces three types of risk. First, there is the risk of loan delinquency and default. The factors determining this risk relate primarily to the individual borrower and the probability that he will repay the obligation. The risk of mortgage default is generally a function of the initial equity investment and rate of loan amortization, the borrower's capacity to repay the mortgage, and the risk attached to the asset itself which is determined by conditions in the local real estate market. The obvious major concern of credit analysis is that the borrower should have adequate income throughout the life of the loan, and a good attitude toward his debts. While there are several key predictors of default

risk, the loan-to-price ratio (correspondingly, the owner's equity) is the most significant theoretical and empirical determinant of default risk. The higher the ratio, the greater the probability of default.[4]

In the event the mortgagor defaults, the mortgagee is exposed to the second type of risk -- that the realized value[5] of the collateral may be insufficient to cover the outstanding balance of the loan. The extent of the lender's exposure to loan loss is determined by the economic factors governing the local real estate market and the institutional procedures regulating foreclosure and redemption. Features of both the mortgage instrument and the asset also affect the ability of and the cost to the lender of evaluating risk, hence his willingness to extend mortgage credit. First, with a long-term contract there is uncertainty regarding future economic relationships. The lender can reduce exposure to loan loss on an _ex ante_ basis by limiting the loan-to-price ratio of the agreement. Second, because of its durability and its geographical location, housing is a unique good. Lenders are obviously concerned with changes in neighborhood characteristics which affect the price of the collateral because the asset is not mobile.[6]

The third type of risk, market risk, is beyond the control of the individual lender. Inflation and the possibility of rising interest rates are the primary market risks which affect the profitability of the long-term, fixed loan and create capital losses for the lender on the mortgage contract.[7] This study considers only the first two types of risk.

Over the term of the contract, the lender's risk exposure corresponds to the sum of the outstanding loan-to-contemporaneous property value and the cost of foreclosure. The latter includes the opportunity costs of foregone loans on the outstanding debt as well as the dollar costs associated with foreclosure proceedings. The lender controls his risk exposure through five means: (1) borrower downpayment, (2) institutional underwriting criteria, (3) quality of appraisal process, (4) collateral appreciation, and (5) mortgage insurance. The first two effectively define the range of risk a lender accepts. The third acts as an independent check on property value against market price. Any deviation perceived by the lender is reflected in the relationship between appraisal value and purchase price, and any deficit is absorbed by the borrower in the form of a higher downpayment requirement. The fourth and fifth elements are implicit and explicit forms of insurance against risk. By granting loans only on those properties which the lender expects to appreciate in value, his investment is protected through the direct reduction in risk exposure over time corresponding to the estimated neighborhood price trend. Mortgage insurance guarantees the lender recovery of the outstanding loan balance, regardless of the market value of the collateral, in the event of default and foreclosure.

The distribution of risk from delinquency and default incorporated in the contractual agreement is shared between mortgagor and mortgagee. In addition to the mortgagee's primary lien against the property, in the event of collateral insufficiency, Illinois law allows him to go against the mortgagor personally for a deficiency

judgment. For the borrower, the loss of home and investment represents the main risk of default. Yet the mortgage contract affords him significant institutional protection which balances the lender's property lien.[8] Within a reasonable time (in chancery's discretion) after default, the mortgagor can tender the amount of the outstanding debt and keep his property -- this is the equitable right to redeem. Even after a judicial sale, the mortgagor has a "statutory period of redemption" of 6 to 12 months during which he can tender the amount bid at the sale and keep his home. If the property goes to someone else, the mortgagor is entitled to the excess of the sale proceeds over and above the amount satisfying his debt to the mortgagee.[9] In summary, the mortgagor's position is protected by the legal expenses of a foreclosure, the long delay before he is dispossessed, during which he may redeem, and the possibility of some return of his investment from the judicial sale.

The shared distributional burden of mortgage finance is a prime example of a balanced "progressive transferal structure".[10] In all long-term contracts, except those where the consideration passes between the parties virtually instantaneously, such a progression governs how the object each side contracted for will be transferred over time. With home purchase under a mortgage, the amortization schedule regulates the increase in the purchaser's "ownership"; to the mortgagor this is "building equity". The progressive structure calls for a big step in the borrower's rights to the property when the downpayment (possession plus a portion of the value of the house) is made, an accumulation of interest in the property in accord with the repayment

schedule, and finally, a warranty deed, free and clear. For the lender receiving the loan repayment according to this schedule there is a direct reduction in risk over time. Each structure is nearly congruent with the other as shown in Figure 5-1. For a given loan amount, the slope of the amortization schedule is a function of the mortgage term and the interest rate.

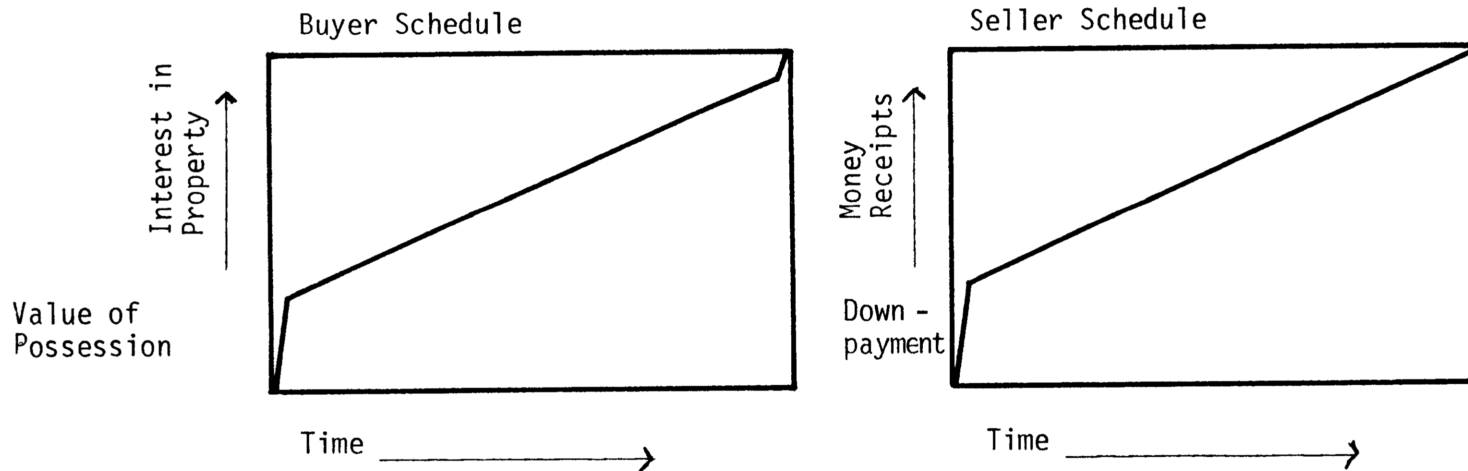
Risk in the Contract Sales Market

The installment contract sale is a conditional sales agreement in which the seller fulfills the dual role of owner and financier. As a financier he buys a future set of payments, and is exposed to the same default risk and market risk as a mortgage lender. But unlike a mortgage lender, he does not relinquish any tangible goods other than immediate occupancy rights. While the financial risks of a low-equity mortgage transaction are higher, certeris paribus, retention of the owner role distinguishes an LIC seller from a mortgage lender and provides the former with greater economic and institutional protection against the last type of lending risk -- loan loss.

First, in the event of default, a seller-financier does not have to liquidate the asset to recover his "loan"; he generally retains title until the probability of payment failure reaches zero. Second, in Illinois, the time requirement and direct costs of foreclosure under an installment sales agreement are minimal compared to those under a mortgage contract.[11] Third, while a seller-financier is still subject to the risks of property depreciation, this is a risk he faces as a property owner, not as a lender. As an owner, he still has multiple property management options: (1) to resell on an LIC, (2) to resell

FIGURE 5-1

Schematic Representation of Progressive Transferal Structure of a Long-Term Mortgage Contract



SOURCE: Greg Colvin, "The Provision For Mortgage Conversion and Title Conveyance in Installment Contracts For the Sale of Residential Property to Blacks in Chicago," unpublished paper, Contract Buyers League files, Chicago, April 10, 1970.

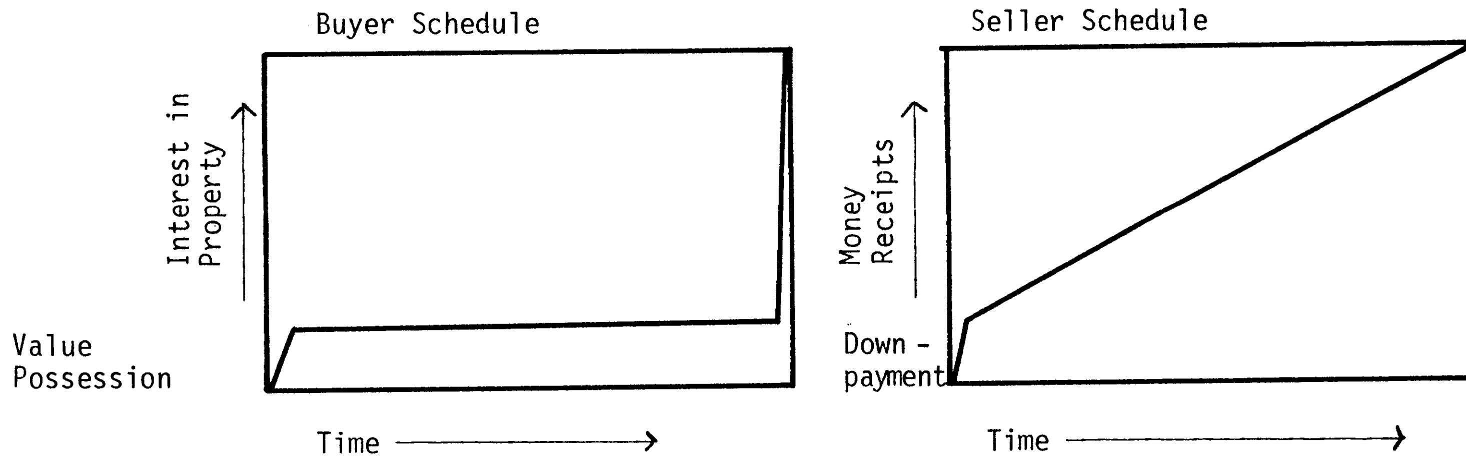
on a cash basis, (3) to rent.

The risks of residential finance do not change with an installment sales contract, but the distribution of the risk burden changes. In Illinois, the greater protection afforded the seller comes totally at the expense of the buyer. The most salient characteristic distinguishing the position of the contract buyer from that of the mortgagor is the lack of institutional protection in the event of a default. Similar to the mortgage loan, the amortization schedule of the contract payment stream regulates the cash flow from the buyer to the seller. But unlike the mortgagor, the rights of the buyer are not congruent with this progressive transfer structure. The contract buyer lacks "equity rights". The downpayment and monthly payments only maintain the right to possession; ownership is conferred all at once upon payment of the last installment.[12] This distribution is shown in Figure 5-2.

If a payment default occurs and continues for 30 days or more, the law[13] permits the contract seller to declare the contract forfeited, retain all payments as liquidated damages, and demand immediate possession. The entire process can take as little as 60 days.[14] In 1961, the Illinois legislature increased the rights of contract buyers purchasing homes thereafter by providing for a flexible statutory period of redemption of at least 60 days if the buyer had paid in more than 25 percent of the purchase price.[15] Nevertheless, in the eviction proceedings the contract buyer still could not raise defenses and the judge would direct the verdict.[16]

FIGURE 5-2

Schematic Representation of Progressive Transferal
Structure With an Installment Sales Contract



SOURCE: Greg Colvin, "The Provision For Mortgage Conversion and Title Conveyance in Installment Contracts For the Sale of Residential Property to Blacks in Chicago," unpublished paper, Contract Buyers League files, Chicago, April 10, 1970.

In economic terms, the land contract represents a poor allocation of rights and risks over the long term of the contract. Over time the "windfall" to the seller in the event of a default increases, while the risk to the seller decreases. The longer the buyer performs, the more tragic his loss if he defaults.[17]

Additional Risk Borne by the Contract Buyer

The lack of equity protection affects not only the delinquent buyer but also one current in his payments primarily because the equity of the buyer is not liquid -- it cannot easily be cashed in if he desires a different housing bundle. If the buyer chooses to move he has three options: (1) to assign his interest in the property to another for a negotiated sum (often only with the seller's consent), (2) to negotiate a property trade with the seller (assuming the latter has additional properties), or (3) simply to let the house revert to the seller and forfeit his entire equity.

The contract sale agreement subjects the non-delinquent buyer to another risk. Independent of his actions, the buyer's investment is vulnerable to acts of the seller that could inhibit or complicate title conveyance notwithstanding complete repayment. The buyer's greatest title disability is that he cannot be assured of receiving a "good" title from the seller. Furthermore, he cannot buy a standard title policy to protect himself as owner of the land because he does not hold title and his interest is vulnerable to the seller's actions.[18] The seller's death or assignment of contract interest can cause procedural trouble for the buyer, but if there is a bankruptcy or an additional property lien(s), the buyer's complete interest stands

vulnerable.[19]

Expected Behavior of a Buyer Under an LIC Agreement

The decision to default is not confined to an inability to repay the loan or a sudden change in income status. If one abstracts from moral commitments and social values, there is an economic rationale to default rather than repay the loan. With the constant monthly repayment schedule, the amount applied to the reduction of principal is at first very small; it grows progressively with the declining outstanding mortgage balance. Consequently, for several years after origination, selling costs exceed equity in a declining, or at least not rapidly rising, real estate market. A mortgagor with a negative equity has a rational incentive to default rather than repay, and any event that triggers a household move is likely to induce default.[20]

While the equation for the contract buyer does not include a selling cost component, the contract buyer's decision is complicated by the all-or-nothing characteristic of installment buying. How the contract buyer behaves with respect to the desire to avoid default and foreclosure depends upon his perception of his housing status -- homeowner or renter -- in addition to the extent of his investment. All evidence this writer has seen suggests that contract buyers considered themselves homeowners; most made substantial efforts to pay (often at the expense of family life)[21] and substantial investments in home improvements.[22] Hence, one would expect buyer correlates of forfeiture to be consistent with those of mortgagors. Of course, all else equal, one would expect higher default rates in this market because of the lower average equity.

Although the buyer considers himself a homeowner, his legal status is closer to the privileged renter. The installment contract transaction is more than a rental but only superficially a sale. As a rental agreement, the contract offers the buyer a long-term, fixed rental payment. As a sales contract, the buyer receives possession and the homebuyer's entitlement to federal income tax deductions for interest and property taxes. It is this latter characteristic that distinguishes the contract sale from a rental agreement and offers the low-equity buyer the potential[23] benefits of homeownership despite his lack of equity rights. With equivalent rental and LIC payments, the buyer theoretically secures a positive long-term cash benefit from the LIC agreement when the sum of the present value of the annual tax deduction savings exceeds the downpayment, all else equal. At that time, the effective LIC payment would be less than the contract rental cost. The lower the downpayment, the sooner the buyer realizes net benefits.

Whether the contract buyer's status is closer to the status of a renter or a homeowner depends on the distribution of risk established by an individual state's legal protection for mortgagors and contract buyers. In California and Maryland, the contract buyer receives protection similar to that of the mortgagor. In general, however, the LIC resembles a rental transaction in that (1) the buyer moves in with little or no downpayment, (2) if a payment is missed, he may be evicted summarily under a rental eviction procedure, and (3) given default, he has no "equity", all previous payments are forfeited.

Expected Behavior of a Speculator Under an LIC Agreement

The increased security provisions of the installment sale and the low cost of foreclosure proceedings provide the speculator with alternative property management options which affect his decision to foreclose or to forbear on a delinquent contract buyer. Unlike mortgage foreclosure, installment contract foreclosure does not represent the final disposition of the loan transaction. It is a selective management option after which the speculator can resell or rent the property. To decide upon the best course of action, the speculator is likely to have greater contacts with the buyer and more knowledge of the buyer's financial position than a mortgage lender, and thus is likely to exercise more forbearance.[24] The decision also becomes less predictable since it is based on subjective assessment rather than on clearly defined indicators.

The contract seller's institutional protection may conversely make him less concerned than the mortgage lender with individual borrower risk. In a strong market, the seller can potentially earn higher profits from repossessions and may in fact decide to use forfeiture and rapid eviction as an operating strategy. By seeking out the least credit-worthy buyers, collecting whatever downpayment possible, and evicting at the first instance of default, he could maximize profits by successive sales and evictions. During the peak of market activity, eviction and rapid resale appears to have been a profitable strategy for certain speculators.[25] In a letter to a business associate, the largest speculator in the west side market noted:

> It would be nice if these contract purchasers would stop paying so we could get the buildings back.[26]

Variation in the average downpayment received by contract sellers strongly suggests that several sellers, large-scale speculators in particular, were greater "risk-takers" than others. These speculators had disproportionately high numbers of forfeited properties and multiple contract sales of the same property. In total, 25 percent of the repossessed properties in the case study had been sold at least once before; 9 percent two or three times prior to the sample transaction. (Because of the effect of the statute of limitation ruling on the distribution of properties in the sample, these percentages understate the evidence of forfeiture strategy during the peak period of market activity.)

Nevertheless, as an aggressive, long-term strategy, the rapid forfeiture-and-resale pattern did not persist. By the late sixties changes in market demand led to an increase in the time lag between repossession and resale and to a reduction in the profits from this strategy, as the high costs of vandalism in deteriorated west side neighborhoods made a management policy of delinquency forbearance and partial payments a more realistic alternative to abandoned buildings and property destruction.

> Speculators learned that "carrying" delinquent payments was not the end of the world. Vacant buildings are quickly vandalized; often beyond repair. A repossessed vacant two-flat or three-flat building [in Lawndale], if not reoccupied within a maximum of five days, would be vandalized to the point of no return. For this reason, it is a matter of record that some 60 percent of Black American contract property purchasers are permitted to continue living in their homes despite payment delinquencies running from one to six months in arrears.[27]

In all fairness, it must be said that such delinquencies were not detrimental to those sellers who had outstanding delinquencies on their mortgage loans.[28] Which delinquency occurred first is unclear. It would not have been uncommon in this market for the seller to be the initial delinquent, particularly if he had stopped speculating in real estate and no longer needed additional mortgage capital.

In an installment sale, the probability of default remains a function of the ability and willingness of the buyer to complete payment; however, given delinquency, the decision to forbear or to foreclose depends upon the seller's alternative management options as well as the probability that the buyer will cure the delinquency. Sepculators may forbear longer than the mortgage lender but they are less likely to do so in those cases where the property is of good quality with good resale value, cash investments are high, and the partial payments from a chronic delinquency are insufficient to cover mortgage expenses.[29]

ANALYSIS OF PAYMENT PERFORMANCE IN THE INSTALLMENT CONTRACT MARKET

An analysis of lending risk in the installment contract market should compare the characteristics of borrower credit risk and the incidence of forfeiture with mortgage market equivalents to determine whether these credit markets actually service mutually exclusive risk cohorts. In the absence of racial discrimination, one would expect this type of segmentation since the higher costs associated with high loan-to-value ratio loans would naturally direct buyers into different

sectors, all else equal. But given the constraints on housing decisions underlying the dual housing market hypothesis, one would expect the risk characteristics of buyers in the installment contract market to overlap with those in mortgage markets.

A comparative analysis of default experience is complicated by several factors. First, an unbiased default rate cannot be calculated from the case study sample data; the annual sale weights for the legal "universe" are unknown. Second, the increased incidence of foreclosures after 1969, on relatively old as well as new contracts, suggests that external factors affected the default decision. Third, the economic and institutional arrangements of installment contract sales affect the integrity of a comparative risk profile assessment. Since the inflated price characteristic of contract sales deflates the value of the downpayment, it distorts an evaluation of the contract buyer's purchasing power in other credit markets.

The Contract Downpayment

The average downpayment for the case study transactions, $1,152, or 5.7 percent of the installment purchase price, does not conform to the conventional notion that contract downpayment represents "little more than a rent security deposit."[30] Only 20 percent of sample buyers put down less than 3 percent and 15 percent put down more than 9 percent of the purchase price. High downpayments were common in the early years of sale activity, but the average declined dramatically -- from 9 percent between 1956-1958 to 4 percent between 1966-1968 -- in the last years of significant activity (Table 4-2).

There is little doubt that the black contract market on average serviced the low-equity homeownership market. The average loan-to-price ratio established the fact that buyers lacked sufficient cash assets for conventional mortgage loans at the contract price. The cash downpayment remained insufficient even when the percentage was recalculated on the assumption that the property could have been purchased at the estimated cash price (PVPRICE). The median loan-to-price ratio corresponding to this hypothetical downpayment was significantly lower than the national figure for conventional mortgages on existing homes. In 1958 the figures were 91 versus 69 percent; in 1960, 92 versus 72 percent; and in 1964, 93 versus 76 percent.[31]

Contract buyers did not lack sufficient cash assets for FHA-insured mortgage eligibility. As shown in Table 5-1, the downpayment of the installment contract equaled or exceeded that necessary to meet the FHA maximum allowable loan-to-value ratio.[32] In 1960, FHA regulations permitted mortgages of up to 97 percent of appraised value on the first $15,000, 90 percent on the next $5,000, and 75 percent on any remaining value up to a maximum loan of $22,500. The minimum downpayment on a loan equivalent to the purchase price of the average installment contract in 1960 would have been 4 percent. Even at the inflated installment contract price, the average contract downpayment of 6 percent more than matched the program's statutory minimum.

Because the installment contract price was inflated and thus higher than FHA appraisal value, the purchasing power of the contract downpayment in a cash market is understated. If one assumes for dis-

TABLE 5-1

Mean Characteristics of FHA-Insured Mortgages and Installment Contract Sales, Existing Homes, Selected Years, 1956-1964

	1956	1958	1960	1964
Existing Single-Family Homes: FHA Section 203 Mortgages, U. S.				
Purchase Price ($)	12,991	13,133	13,284	14,540
Loan-to-Value Ratio (%)	81.1	88.5	90.8	93.1
Loan-to-Acquisition Cost Ratio (%)	77.5	85.8	88.7	92.3
Term of Mortgage (years)	22.5	24.2	25.8	28.4
Mortgagor's Investment ($)	2,993	1,915	1,532	1,146
Maximum Allowable Loan-to-Value Ratio (%)*	93	93	97	97
Existing 1-4 Family Homes: Installment Contract Sales, Chicago				
Purchase Price ($)	22,632	18,633	21,642	18,863
Loan-to-Price Ratio (%)	88.0	92.8	93.9	95.2
Term of Contract (years)	13.8	16.3	18.6	19.7
Contract Buyer's Investment	2,921	1,289	1,334	874
Contract Buyer's Investment as a Percent of FHA Value Home	22.5	9.8	10.0	6.01

SOURCE: FHA data from U. S. Department of Housing and Urban Development, _1967 Statistical Yearbook_ (Washington, D. C.: Government Printing Office, 1968), FHA Table 33.

* Individual maximum allowable loan-to-value ratios are calculated on a sliding scale according to set increments. In 1960, FHA regulations

TABLE 5-1, continued

permitted 97 percent of appraised value on the first $15,000, 90 percent on the next $5,000, and 75 percent on any remaining value up to a maximum loan of $22,500. See Henry J. Aaron, Shelter and Subsidies (Washington, D. C.: Brookings Institution, 1972), Table B-4.

cussion purposes that the availability of FHA finance would have enabled contract buyers to purchase at the PVPRICE, the application of the same cash assets would have effectively raised the average downpayment to 8 percent. If the black contract buyer had had access to the lower cost, average FHA home, this would have similarly increased the purchasing power of his cash assets.

Payment Status of Contract Buyers

Long before the advent of the Contract Buyers League, black contract purchasers realized the pitfalls of contract buying and experienced a "souring" of their expectations for homeownership.[33] Many quickly discovered that monthly payments exceeded anticipated levels because sellers failed to mention the payments for taxes and insurance. Given the condition of some homes, there were additional expenses for new heating equipment and repairs to remedy building code violations. These repairs were often financed by the seller. In addition, the expectation of additional income from apartment tenants often failed to reach anticipated levels or to provide a reliable souce of income. Over time there were problems with vandalism and securing "good" tenants; some buyers decreased the rent to get "good" tenants, others tried to avoid renting.[34] But for most, the latter solution was impossible. Just to meet the payment obligation, rooms were rented to lodgers, moonlighting jobs became more frequent, and wives went to work if that was not already the family norm.

It is impossible to statistically measure how often contract obligations altered family relationships and strained financial resources. However, there is little doubt among those personally

familiar with contract buyers that the strains were intense and widespread.

> We had to let everything go to pay. We didn't do anything but pay. We paid food, the housenote, and repairs. That was all. Even then we was late with our payments...There was all this strain. We was going like mad just to keep up. I was afraid to miss a day's work and my husband was the same...There's nothing relaxing about buying your home on contract.[35]

The inflated nature of the contract purchase price contributed to the buyer's burden to remain current and avoid forfeiture. The high burden for non-forfeited as well as forfeited contracts testifies to the tenacity with which most buyers held on to the belief in home-ownership.

The belief in homeownership surmounted negative feelings about contract buying. Contract buying had developed a "bad" reputation among many blacks and at all times there was widespread reluctance to admit that one had bought on contract. Buyers felt that they had been "caught" by an "exploitative situation," taken by "the man."[36] Pride and pressure kept many quiet and paying. Others learned to adapt to the reality of poor deals because they had "too much invested to throw away," "they would stay until the children grew up," or they had fixed up the house "the way they wanted."[37] Others simply walked away from the property.

The vast majority of contract buyers, however, persisted in paying on the contract agreement. Ten percent of the buyers in the sample succeeded in completing payment and received property deeds, although at least half of these buyers had formally been delinquent several times during the payment term. Table 5-2 presents this infor-

TABLE 5-2

Status of Sample Installment Contract Sales, 1973-1975

	Number		Percent	
Terminated				
Buyer completed payment, received deed	48		10.0	
Conversion of contract to mortgage loan, received deed	158		32.9	
Conventional mortgage		29		18.2
FHA-insured mortgage		74		47.2
Purchase money mortgage		55		34.6
Forfeiture-repossession	98		20.4	
Still in Force				
Original buyer paying	166		34.5	
Assigned interest to another	11		2.3	
Total number of contracts	481*		100.0+	

* Information missing for 84 cases.

+ Total may not add to 100 due to rounding.

mation on the status of sample contract sales between 1973 and 1975.[38] Thirty-five percent of the buyers were still paying under the terms of the original contract;[39] 33 percent of the buyers managed to have their contracts converted to mortgage arrangements, although 35 percent of these mortgages represented purchase money mortgages given by the contract seller. While the terms of the payment in these mortgages did not differ from the LIC, the buyer secured title to the property.

Ninety-eight contract properties were repossessed between 1963 and 1975 out of 482 sales during the 1956-1968 sample period. It is impossible to determine how many of these cases were attributable to factors which unpredictably altered family circumstances, events such as illness, death, divorce and unemployment. The data on forfeiture is limited to *ex ante* characteristics of the transaction. Any conclusions about individual factors made from this evidence of contract performance must therefore be interpreted as correlates with the probability of default and forfeiture, rather than determinants of buyer default.

In exploratory regression analyses of forfeiture status, only two variables -- the identity of the speculator holding the contract paper and contract downpayment -- were significantly related to forfeiture status. Five large-scale speculators held a disproportionate number, 58 or almost 60 percent, of these "bad" contracts and only 36 percent of the sample properties. Contract downpayment for the forfeited cases, shown in Table 5-3, averaged 4.5 percent compared to 5.9 percent for non-forfeited properties. However, not all defaulting

TABLE 5-3

Mean Characteristics of Sample Installment Sale Transactions by Forfeiture Status

	Non-forfeited	Forfeited		
		All	Before 1969	After 1969
Time lag between LIC purchase and repossession (years)	--	5.7	3.5	8.4
Outstanding contract balance (%)		78.7	89.5	71.9
Risk Characteristics				
Contract downpayment (%)	5.9	4.5[a]	4.1	5.0
Contract term (years)	17.6	18.3	17.8	18.8
Arbitrage premium ($)	5,263	6,123[a]	6,448	5,688
Contract payment burden (%)	31.8	33.7	35.6[c]	31.2
Borrower Characteristics				
Age at time of LIC sale (years)	40	37[b]	35	38
Number of children at time of LIC sale	3.0	3.5	3.3	3.6
Price and Profit Characteristics				
Contract purchase price ($) (1957-59 constant dollars)	19,583 (19,029)	20,183 (19,409)	21,487[c] (20,671)[c]	18,514 (17,793)
Net markup (%)	66.5	75.4[b]	68.0	85.3
Present value expected net profit ($)	2,612	3,058[b]	2,997	3,139
Monthly net cash flow ($)	45	49	50	47
Neighborhood Characteristics				
Percent housing units substandard (1960)	12.2	11.0	9.7	12.8
Number of observations*	465	98	55	43

* Number of cases may vary for individual variables.

TABLE 5-3, continued

a. Difference in means between forfeited and nonforfeited cases statistically significant at .05 level.

b. Difference in means between forfeited and nonforfeited cases statistically significant at .10 level.

c. Difference in means between before and after 1969 forfeiture statistically significant at .05 level.

d. Difference in means between before and after 1969 forfeiture statistically significant at .10 level.

buyers had low downpayments; in 5 percent of these forfeited contracts downpayments exceeded 9 percent. Other differences between forfeiting and non-forfeiting buyers were small, but they conformed to the expected pattern for mortgage default. Those buyers who forfeited their contracts were, on average, younger, had a greater number of dependents under the age of 18, and accepted a larger contract payment burden.

These findings are important because they imply that the correlates of contract buyer behavior are similar to those in mortgage markets. The predictive power of the loan-to-price ratio in mortgage markets would seem to carry over into the private finance, low-equity sector. In addition, the low average age of the contract at the time of repossession, 3.5 years for properties repossessed prior to 1969, conforms to loan-seasoning behavior in mortgage markets.[40]

Nevertheless, the incidence of property repossession is not an accurate index of the extent to which buyers encountered difficulty meeting the payment burden. Rather it is an index of the relative profits and risks from continued seller forbearance. Forfeiture was as much a function of how accounts were serviced as of borrower credit. Payment delinquency was not uncommon in the contract market. The short 30-day default period written into the contract increased the probability of formal delinquency. However, the cash-flow spread between the mortgage commitment and the contract generally provided the speculator with sufficient flexibility to meet his mortgage expenses from sizeable partial payments. The speculator could afford to forbear.

Permissive Delinquency or Repossession: The Choice of the Speculator

Given that delinquency was not uncommon, what were the precipitating conditions for repossession? What characteristics distinguished the delinquency non-repossession cases from the repossession cases?

Data on payment performance over the life of the contract was available only for those cases where a contract payment ledger remained on file. These records could be obtained for only 113 contracts written by two large-scale south side speculators, former partners who maintained similar business operations.

Professional ghetto landlords and contract sellers, Peck and Master managed delinquency for profit. Contract buyers were charged for delinquencies in accordance with the duration of the late payment. Thirty days after payment was due, the buyer was charged $10 and received a Notice of Payment Default. After an additional 30 days, the buyer was charged $25 and sent a Notice of Intent to Declare Forfeiture; this was followed by a $60 charge for Declaration of Forfeiture proceedings.[41] These fines and "legal fees" were deducted from the monthly contract payment prior to principal and interest allocations. Given Peck and Master's choice of cost-recovery taxation for deferred capital gains, these charges represented "expenses" which increased the basis of recoverable costs and extended the period of deferred taxation.

Table 5-4 presents evidence of Peck and Master's practice of "permissive delinquencies". Technically these sellers could have foreclosed on the average delinquent buyer several times during the course

TABLE 5-4

Mean Characteristics of Purchase, Delinquency and Default for Peck and Master Subsample of Installment Sales

	Non-forfeited		Forfeited	
	No Delinquencies	Delinquencies	Before 1969	After 1969
Forbearance Characteristics*				
Number delinquency notices	--	26.9	11.5	28.5
Number forfeiture intent notices	--	3.0	4.5	5.5
Number forfeiture suits	--	0.8	3.0	1.6
Risk Characteristics				
Contract downpayment (%)	5.8	5.2	0.7	6.1
Contract payment burden (%)	30.6	31.7	29.1	30.0
Borrower Characteristics				
Age at time of LIC sale	47	43	32	43
Number of children at time of LIC sale	1.8	2.7	na	3.7
Price and Profit Characteristics				
Contract purchase price ($) (1957-59 constant dollars+)	18,383 (18,073)	18,809 (18,460)	14,900 (14,248)	18,005 (17,472)
Net markup (%)	65.3	75.9	na	75.7
Monthly net cash flow ($)	46	45	38	51
Neighborhood Characteristics				
Percent housing units substandard (1960)	15.2	11.9	16.0	14.3
number of observations+	28	69	2	20

* Number of times which a speculator charged a fee for the respective situation.

+ Number of cases may vary for individual variables.

na = information not available.

of the contract. The incidence of delinquency did not appear to be a determining factor for repossession since the incidence of delinquency on average did not differ for forfeited and non-forfeited delinquent contracts.

In interviews with members of the Contract Buyers League conducted by volunteer researchers, many buyers noted that delinquencies were caused by sporadic inabilities to meet monthly payments due to unemployment or illness.[42] One west side speculator considered such forbearance altruistic:

> I like the people on the west side. I was good to them. I lent them money. I did them favors. And I acted as a father confessor. I didn't know I was doing any harm to them.[43]

Being "nice" to "worried" contract buyers was not without its financial rewards. This was particularly evident for the Peck and Master cases because they had an established policy on late payments. The additional income from late fees and legal charges for preliminary notifications of default proceedings often provided a significant additional component of profit. In one particularly striking example, representative of at least 12 other cases, the increase in buyer debt over a 13-year period exceeded $1,000 or 8 percent of the sale price. This figure covered 98 charges for 30-day notices and 3 charges for forfeiture notices.

A pattern of chronic late payment would lead one to expect a slow reduction in the outstanding balance. This was not necessarily the case. Many buyers were delinquent but diligent and continued to consistently pay both late charges and contract obligation, thereby steadily reducing the contract debt. In the above example, monthly

contract payments of $115 (principal and interest) on an initial balance of $12,700 at 7 percent interest implied a term-to-maturity of almost 15 years. Fourteen and a half years later the outstanding balance totaled $866; it would take only 8 months of regular payments to complete contract payment.

One observer of the declining west side market cited continued occupancy as the biggest advantage to forbearance. In several neighborhoods which had experienced severe deterioration, the costs of vandalism following buyer eviction exceeded the benefits of property repossession if resale did not immediately follow eviction.[44] The geographic distribution of repossessed porperties before and after 1969 supports this view of the west side market. The earliest sample properties repossessed are disproportionally west side properties; after 1969, south side properties predominate.

It is difficult to determine the precipitating conditions for repossession. At the present time there is no way to determine how many buyers walked away from contracts and how many cases represent the seller's decision to terminate long-term delinquencies. Normally one would assume that the buyer's actions determine loan default. However, the high incidence of delinquency for both repossessed and non-repossessed delinquent contracts and the lack of distinguishing differences in buyer characteristics for these subgroups caution against relying upon this assumption as the total explanation.

There are two observations which conform to this writer's expectations of speculator motives for repossessing a particular property. First, the slightly larger cash flow evident in the repossessed

properties may have provided a greater incentive to try and resell the property instead of continuing to forbear. Of greater significance is the fact that a large proportion of the repossessed properties had a history of previous repossessions. Twenty-five percent of all forfeited contracts had been repossessed from a single previous contract sale; 7 percent had been repossessed twice, and 2 percent, three times. An additional 17 percent of the repossessed properties provided the speculator with rental profits for a year or more prior to the contract sale. For the Peck and Master subsample these proportions exceeded 27 percent for properties with prior contract sales and 45 percent for those with prior rental profits.

A large number of repossessions occurred between 1970 and 1971 and were concentrated on the south side among three speculators, Peck, Master and Engle. Their combined total accounted for 65 percent of all post-1969 repossessions. Several of these repossessions were properties sold in the late 1950s, while only three out of the 55 pre-1969 repossessions had been sold during this time period. The Peck and Master delinquency data further suggest that the post-1969 repossessed contract buyers were different because they had a history of late payments.

The long time lag between purchase and repossession for these post-1969 properties, and the lack of distinguishing buyer characteristics between the two periods suggest that the precipitating events for both buyer and seller relate to significant institutional changes in the contract market in the late 1960s. For some buyers, the extensive market pattern of seller "exploitation" and transaction markups re-

vealed by the Contract Buyers League shattered any remaining hopes for homeownership, of ever paying off the contract balance.[45] The availability of FHA mortgage money in these neighborhoods altered the sellers' options by providing a means with which to cash out of numerous properties. This incentive evidently increased after the CBL payment strike, as some sellers pressed on buyers with long-term delinquencies which had previously been ignored.[46]

Assessing the Risks of Installment Sales

A major argument in the contract speculators' defense against charges of discriminatory price setting rested on the proposition that prices charged in this market reflected the additional risk of credit transactions. For individual owners selling directly on contract without benefit of excessive mortgage leverage, this was a credible argument. However, the marketing and management strategies of the speculators' operations effectively minimized the ascribed risks of contract sales. High mortgage leverage limited a seller's absolute risk exposure at the outset and subsequent refinancing of mortgage loans maintained high leverage throughout the term of ownership. Second, the land trust vehicle limited personal liability. Third, multiple turnover of properties testified to the effectiveness of title ownership as a risk-compensating feature of the contract sale. But most importantly, institutional financing shifted contract loan-loss risk to the mortgagor; a speculator could default on the mortgage without sacrificing his accumulated profit.

The rewards of contract selling in the black contract market, by any standard for "prudent" rates of return, were enormous. The

annual rate of return, based on the conservatively estimated equity, averaged 72 percent for the west side and 110 percent for the south side.

For the contract buyer, the risks of installment purchase were not confined to his deferred title claim or his legal eviction status as a renter. Homeownership has traditionally served as the primary means by which low- and middle-income families built an asset base, moving up a social mobility ladder by increasing the quality of housing purchases. For the first-time black homebuyer, the unanticipated consequence of contract buying was the inability to fully recapture stored equity. The lack of equity rights inhibited trading-up and geographic mobility often entailed an investment sacrifice unless the buyer could find another willing to purchase the contract "rights".

A contract buyer having successfully attained title ownership was still liable to sustain capital losses from a property sale. Because contract sale prices adjusted for credit constraints particular to a neighborhood or borrower, the terms of the contract did not reflect a cash market relationship between the value over time and debt payoff which was common with mortgage finance. Unless the contract homeowner subsequently sold on contract, there was a high probability that he would sustain capital losses unless there had been an increase in neighborhood property values.

The social costs of contract buying can be seen in the neighborhoods of Lawndale, Garfield Park and Englewood. A decade after racial transition, the neighborhoods of heavy contract activity had

become an established part of the black ghetto. The socio-economic gains sought by contract buyers dissipated with the deterioration of their neighborhoods. Having sought homeownership as a means of improving their environment, individual contract buyers became "innocent victims of their surroundings" unable to overcome the tide of subsequent decline. While neighborhood decline might have resulted despite an availability of mortgage finance, speculative contract activity accelerated the decline. It is clear that the inflated price structure of contract sales did not increase the probability of neighborhood stability commonly associated with owner-occupancy. This had less to do with individual motivations and lack of property appreciation than with the deferred maintenance and overcrowding which resulted from the severe financial burden of contract payments, a burden which would have been less straining with FHA-insured mortgage finance.

CHAPTER 6

FHA's Inner-City Mandate and Redlining: Lessons from the Installment Contract Market

> In areas where speculators constitute the principal means by which properties are marketed and FHA is the principal source of financing, this [modified cost] approach to value will help to prevent unreasonable disparities between net sellers' prices plus typical costs and FHA values with the attendant implications of excessive speculator profits.
>
> FHA Circular HPMC-FHA 4035.8 Change 1
> March 4, 1971.

The analysis of installment contract sales is a case study of economic and institutional relationships in the dual housing market in Chicago during the two decades following World War II. The installment sales market developed as a specialized response to institutional discrimination. Are the lessons of this market tied to the specific financing instrument? What generalizations about the characteristics of racially divided housing markets can be drawn from this experience?

Since 1968, installment contract sales have not been a significant feature of the black housing market in Chicago. As a consequence of FHA policy reforms in the late 1960s sanctioning mortgage insurance on property in older inner-city neighborhoods, this type of mortgage has been the principal form of mortgage credit in these neighborhoods, particularly those experiencing racial transition. In an historic reversal, the effectiveness of its reform actions has stimulated criticism of its new role as an agent of racial change and its mortgage processing operations as a source of speculative profits.[1]

As a case study of the dynamics of housing market changes in transitional neighborhoods, contract selling provides a foundation for exploring the pattern of market behavior in these neighborhoods which followed the change from installment sales to FHA-insured mortgages.

Did the availability of mortgage credit alter the circumstances under which units in the white market were transferred to the black market?

Critics of the effects of FHA reforms in inner-city mortgage markets have defined the housing finance problem in the negative as the "lack of institutional involvement in the community." In so doing, they have narrowed the historical definition of redlining -- the denial of conventional mortgage money by local lenders. First defined in the late 1950s as the absence of _all_ institutional mortgage credit in selected geographic locations regardless of borrower credit, the term redlining now connotes the absence of _conventional_ mortgage credit in selected geographic locations regardless of borrower credit.

As the precursor to FHA-insured mortgage credit in older inner-city neighborhoods, the contract market experience provides the historical foundation for understanding the current redlining controversy. Until 1966, contract sales filled the credit void when both FHA and conventional lenders openly redlined neighborhoods experiencing racial transition. The involvement of financial institutions as mortgage lenders for contract speculators provides a basis for understanding the origins of several conventional mortgage lending procedures and regulations which have been cited as negative incentives for inner-city lending.

The Legacy of Illinois "Problem" Savings and Loan Associations

Beginning in 1963, the Federal Home Loan Bank Board (FHLBB) promulgated a number of administrative regulations designed to prevent "unsafe or unsound lending practices." Administrative regulations

controlling loan volume to a single borrower, appraisal policy, loan application record keeping, deferred income accounting for loan fees and discounts, and the type of loans to be used as collateral for loan advances from regional FHL banks were directed toward preventing lending practices typical of those Illinois "problem" associations involved in the finance of speculative contract sales.

Three years later, Congress passed the Supervisory Act of 1966 which significantly increased the supervisory powers available to the FHLBB for a "campaign of preventive supervision."[2] The Act granted the FHLBB "intermediate" powers to issue cease and desist orders, to suspend and remove association officers, and to appoint conservators or receivers for financially threatened institutions.[3] These powers were designed to complement the stronger but drastic powers to terminate insurance of accounts or seize an institution.

The Illinois experience provided supervisory agents and regulatory examiners with a costly lesson in the problems which result from inner-city lending to real estate investors.[4] A 1969 memo carefully detailed the investment problems of speculative mortgages, procedures for examination detection and suggested supervisory responses.[5] FHLBB examination procedures reflected an increasing concern with concentrated geographic lending. The development of institutional performance measures, designed as inputs for determining the frequency and type of supervisory examinations, included an evaluation of the "economic environment" of the association's lending area. This latter measure would monitor more closely "potential or incipient operating weaknesses before they affect significantly overall association

performance."[6]

Two other regulations, soft-spot examinations and differential reserve requirements for certain classes of mortgages, were also designed to catch speculative investment patterns and other lending problems in the early stages of development before they became "apparent and inescapable."[7] The soft-spot examination procedure, initiated in 1970, increased the frequency of scheduled examinations for associations in "economically depressed areas," regardless of an association's loan record. Earlier reports noted that associations in these older inner-city areas were "obviously most likely to have a number of loans on old properties"[8] and the areas were considered "on the average more vulnerable than others and might have internal difficulties generated by adverse conditions in their areas."[9]

Beginning in 1964, the Board revised the basis for credits to loss reserves which insured institutions must make before payment of dividends. It required higher reserves for those associations with abnormally large amounts of slow loans and real estate owned.[10] In the seventies there were reports of differential reserve requirements for inner-city mortgage loans based on zip code designations.[11]

Many of these regulatory actions and supervisory procedures were a natural product of increasing self-monitoring following a decade of growth within the savings and loan industry. Nevertheless, the timing of and perceived need for these specific regulations were significantly determined by the regulatory frustrations and monetary costs incurred in the disposition of Illinois "problem" associations.

In his report to the industry on the causes of association failures, Bartell concluded:

> Thus, in one sense, it could be said that all associations engage in concentration of loans by geographic area and by type of security. The principal cause of failure is not concentration per se, but concentration in risky loans. Experience indicates that a large portfolio of loans in a growing middle class suburb is not risky; the same degree of concentration in a deteriorating neighborhood of the central city is.[12]

This conclusion minimized the additional risk attributable to the speculative nature of the mortgages financing inner-city contract sales. These were riskier loans in part because they were two-tiered loans in which payment had to pass from the contract buyer to the speculator to the lending association. The contract neighborhoods were older neighborhoods but all were not "deteriorating" when the loans were initially written. While the decline in property values underlying mortgage loan losses in the Lawndale-Garfield Park area was likely a function of "unemployment and income instability," loan loss was also a function of unsound lending practices. The nature of the property sale transaction exacerbated a difficult situation. By omitting consideration of the speculative process underlying these property transfers, Bartell's conclusion implicitly extends the high-risk classification to all inner-city neighborhoods and reinforces the organic life cycle theory of neighborhood decline.

From "Economic Soundness" to "Acceptable Risk": The Short-Term Effects of a New FHA Underwriting Policy

In 1966, FHA amended the National Housing Act through the addition of Section 203(1), which relaxed the "economic soundness" require-

ment for mortgage insurance and substituted the "acceptable risk" standard. Stimulated by the urban riots of 1965 and 1966, the intent of the change was to offer insured mortgage financing to " credit worthy" individuals who had been innocent victims of their surroundings...[to make] it possible for responsbile citizens to remain in an area and to form a stable nucleus of home owners."[13] In operational terms, this meant that if the particular unit met the minimum property standards and the mortgagor qualified, the mortgage was insurable under non-subsidized Section 203(b) even though certain neighborhoods would not permit a finding of economic soundness.[14] In 1968, Section 203(1) was replaced with Section 223(e), which expanded the areas in which exception to the economic soundness criterion could be made by liberalizing the location criterion to "reasonable viable" areas.[15]

Because the FHA "was never a financial vehicle in the city of Chicago until 1968 as far as single family homes or properties were concerned,"[16] the policy revisions created technical and administrative problems for the Chicago field office. Older appraisers could not abandon their previous training to disregard the economic life of the surrounding neighborhood; new appraisers had to be hired and trained.[17] The increased demand and heavy workload which resulted from the policy switch necessitated the hiring of fee appraisers for the single-family work. Some of these fee appraisers were real estate brokers and a conflict of interest developed, since they appraised in their local market areas.[18]

Reports of alleged bribery, kickbacks, and other irregularities involving HUD employees and private individuals doing business with the

Chicago office began to surface in the early seventies, "choking" the capabilities of the federal district prosecutor's office.[19] By 1973, the regional administrator of Region V had concluded that many of the programmatic abuses were a "direct result of both a lack of training, experience, and expertise, and in many instances, dishonesty of fee appraisers. Accordingly, all use of fee appraisers in the city of Chicago was terminated."[20]

One immediate effect of the FHA policy change and laxity in administrative procedures was the renegotiation of numerous contract sales in deteriorated neighborhoods on the west side of Chicago.[21] By 1969, 12 percent of the sample contract sales had been converted to FHA-insured mortgages; another 4 percent would be converted within as many more years. At least two large-scale speculators used FHA finance to divest themselves of those contract-backed mortgage loans for which they were personally liable or those contracts with collection problems. Many more viewed FHA conversion as a means of minimizing their liability in the pending CBL lawsuit.[22]

The broader inpact of the FHA policy change in Chicago and other cities occurred in those urban neighborhoods contiguous with the 1960 ghetto experiencing racial and economic transition. By the mid-seventies, numerous case studies had shown that FHA-insured mortgage credit had become a racial border phenomenon differentially serving blacks.[23] How would the availability of FHA-insured mortgage credit affect neighborhood racial transition? By one account, FHA financing was likely to increase the demand for housing in these neighborhoods relative to that obtaining in its absence, reverse the depressing

price effects attributable to the absence of mortgage credit, and also accelerate the speed of transition. The path of neighborhood development, however, would continue to depend upon the anticipations of social, economic and racial change held by buyers, sellers and other lenders.[24] Therefore, neighborhood decline or stability would not be predictable solely on the basis of the availability of FHA finance.

If the FHA policy change promoted neighborhood change through a relaxation of the neighborhood homogeneity criterion for inner-city lending, at the same time it limited and even reversed the rising levels of cash and private transactions characteristic of this real estate market.[25] With the availability of FHA credit, an installment contract sale was clearly not the best instrument with which to shift housing units between white and black markets. A cash transaction utilizing mortgage credit would yield an immediate return to the speculator at the time of the real estate closing.

The availability of FHA-insured mortgage credit, however, did not alter the economic incentives or regulatory inhibitions confronting conventional lenders evaluating loans in these neighborhoods. There was no change in attitude regarding "no integration" loans. The availability of FHA credit insurance produced a change in the cast of lenders, but only one form of mortgage credit remained available. The significant difference was that the availability of mortgage finance theoretically increased the probability of direct transactions between white seller and black buyer and thus reduced one incentive for credit arbitrage.

In the past, the lack of institutional mortgage finance in transitional neighborhoods, not the type of institutional mortgage finance, was viewed as the critical element permitting the contract sale market to flourish in a finance vacuum. The changeover in FHA insurance criteria had a striking effect upon the perception of the housing credit problem in racial transition neighborhoods. Communities contiguous to established black neighborhoods continued to experience pressure applied by the real estate industry to sell "block by block and turn over these neighborhoods."[26] The difference between the 1960 situation and the one in 1973 was that in 1973, the social and economic fate of these neighborhoods, as described by community spokespersons, was tied to the fact that FHA financing was the only type of mortgage finance available. Neighborhoods became impacted by the stigma of federal mortgage insurance programs: "We have FHA money for quick sale."[27]

White community groups at hearings on the oversight operations of FHA programs in Chicago complained about racial steering tactics of real estate agents, disinvestment by conventional lenders, excessive points paid by resident owners to sell homes with FHA-insured mortgage credit, profits by panic peddlers, and collusion among these parties.

> The abuse of FHA has become the syphilis infecting society. Mortgage houses align themselves with the program by withdrawing conventional loans from areas which are changing and insurance companies follow suit by redlining these areas -- determining them to be high risk, thereby withdrawing their policies or jacking up the rates. FHA falls right in line by mothering these policies through granting loans in the area determined by realtors. This is going to stop. We don't want our cities and lives planned by the people who are out to make a fast buck.[28]

The singular availability of FHA-insured mortgage credit was now responsible for a situation whereby speculators could "palm off" inferior buildings on "unsophisticated buyers, people who were desperate for a home but didn't know much about quality housing."[29] Liberal financing allowed low-equity buyers to acquire a home "without the experience that was necessary to maintain that home, to take care of it."[30]

These community groups complained about the concentration of minorities in only certain areas of Chicago, the "resegregation" of communities that was not "in line with the Federal program" which "was never meant to be used that way."[31] FHA was not "careful" with the way it made funds available for mortgages.

The solution to this "drastic FHA problem" was a modified quota system. Court orders would define fringe areas of Chicago, stop FHA sales in these areas, and force the FHA 203 program to be utilized throughout the remaining Chicago metropolitan area.

> They should spread out the availability of FHA mortgages so that in any given community, any given census tract, there would never be more than 5 percent of the available housing per year sold, exchanged through FHA.
> This would give you a 95 percent of the stability of the existing community.[32]

With a clear understanding of what forms of finance would be utilized in the absence of FHA mortgages, these groups further called for a ban on contract sales in the court-defined fringe areas. To support real estate activity, these groups called for credit rationing of conventional mortgage loans to prevent panic selling and other psychological abuses which occur with FHA and contract sales.[33]

The anger of white residents of older, inner-city neighborhoods, directed at the FHA as a force of social change, sparked the current redlining debate which focuses on the withdrawal of conventional funds. FHA was now culpable for doing what it was accused of not doing in the past. At least one minority group said so much when a representative attributed the "violent attacks against the FHA" to its policy of financing real estate without discrimination."[34]

Black representatives did not define the problem in these terms. The changeover in FHA policy immediately altered the financing vacuum in transition or impending transition neighborhoods and increased the opportunities for black homeownership. Black representatives at the oversight hearings notably did not comment on FHA's administration of inner-city mortgage programs, but lamented the moratorium on the Section 235 subsidized homeownership program.[35] Despite the abuses of the FHA programs, a mortgage was better than a contract.

Several sources indicated that the availability of FHA mortgage finance did not alter the established pattern of blockbusting panic selling and speculative transactions common to Chicago transition neighborhoods.[36]

> The speculators' markups are fantastic. On Hubbard Street...a speculator bought one place for $7,500 from a white family. He sold it to a black family for $14,500, and it was riddled with code violations...
>
> The same speculator bought another house for $5,000 and sold it for $14,500 FHA.[37]

Collusion among market actors was not uncommon either. If a speculator acted as a broker-intermediary in a black-white transaction with FHA finance before May, 1972, he probably received a kickback from the mortgage banking house originating the FHA-insured mortgage,

in addition to his regular sales commission.[38] In some instances, speculators benefitted in two capacities -- broker and loan originator, by virtue of their ownership or association with mortgage companies.[39]

FHA recognized the significant impact of speculative transactions upon its inner-city lending program in a series of administrative directives aimed at tightening procedures and improving financial performance in areas dominated by speculator activity. A July, 1970, circular titled "Intensive Valuation Review in Problem Areas" emphasized that "FHA has done more harm than good" to low-income purchasers in those cases where the liberalized FHA procedure for Section 223(e) resulted in insurance of mortgages "the physical security for which is far below the stated objective of the FHA Minimum Property Standards." The circular stressed that 223(e) was not to be interpreted as permitting the waiver of FHA minimum property standards.[40]

Another circular dated December, 1970, required the delineation by the Chief Appraiser of "all inner-city, transition and problem areas where there is evidence of substantial speculator activity," and added stricter regulations for review of appraisals in those areas. The enumerated review procedures suggested that previous procedures entailed a cursory review _after_ the FHA commitment had been issued.[41]

Another directive was issued in December, 1970, in which FHA initiated a "modified cost approach" for existing property appraisals in speculator-dominated areas to "facilitate more realistic appraisals" and to prevent "excessive speculator profits." The modified cost approach was to be used as a supplement to the market approach for the valuation of properties owned less than two years by a non-occupant

seller and located in a delineated area.[42] It limited the selling price to the lower of either comparable market value or the seller's acquisition price plus repair costs, holding costs, sales commission, and an allowance for overhead and profit.

> A reasonable profit is one which is required in order to attract legitimate enterprises to engage in the purchase, repair or rehabilitation, and resale of older properties in the locality. The profit allowance must be such that it will discourage the "speculator" or "suede shoe" operator. The purpose is to exclude from FHA insured mortgages the possibility of exorbitant profits at the purchaser's expense.[43]

This "reasonable" profit allowance, pegged at 25 percent of total modified cost value prior to an adjustment for the broker's commission, provides a lower bound estimate of average speculative markups.

FHA Loan Origination and Discount Points: The New Instrument for Capturing Profits from Racial Change

FHA-insured mortgages are usually originated by specialized mortgage companies and subsequently sold to large permanent institutional investors such as insurance companies, mutual savings banks, and FNMA. Mortgage companies earn a profit first through loan origination, and second through loan servicing.[44] Since FHA mortgages are generally sold at a discount, for example 97 percent of face value, the originator increases the number of front-end points to generate a profit so that when the loan is sold in the secondary market a cash balance remains. These points, paid by the seller of the home, can be absorbed in either of two ways: through an increase in the sale price so that the discounted, inflated sale price matches the original price estimate, or through a partial reduction on equity recovery.

The point system has been a constant feature of FHA financing. It is designed to compensate for the FHA-fixed interest rate ceiling which historically has been less than the prevailing market interest rate. Rather than increase the interest rate ceiling, FHA has permitted lenders to charge discount points as an inducement to make loans at the FHA-approved interest rate. By indirectly raising the effective rate of return, the system encourages investment in the home mortgage market.[45]

A mortgage lender maximizes FHA mortgage origination profits by concentrating mortgage lending on those properties which will generate the highest discounts yet conform to FHA underwriting criteria. After 1966, these have been mortgages in areas considered "too risky" by conventional lending standards. Neighborhoods of impending or early racial change have historically fit this characterization.

In the past, the underwriting criteria and portfolio preferences of permanent institutional investors, factors which effectively precluded loans to blacks and loans in transitional areas,[46] constrained placement of profitable but non-conforming FHA mortgages. In the mid-1960s as mortgage banker-correspondent ties began to weaken, mortgage originators' dependence on FNMA purchase commitments grew. During this period, the FHA policy revisions were implemented. Any FHA-insured loan became acceptable to FNMA and thereby assured mortgage originators of an outlet for all FHA loans.[47] This combination of factors lifted the locational constraints on loan origination and precipitated volume FHA lending in changing areas and accelerated the transition process.[48]

The system of FHA loan origination became a vehicle with which to profit from the social and economic uncertainties of racial change much the same way installment contract sales were used prior to FHA mortgage availability.[49] Both instruments guaranteed a high return with little or no risk to the originating party. FHA loan originators benefitted from racial change because, in the absence of conventional financing, it provided a captive market, one in which they could charge a discrimination premium to transfer units from white to black markets. To the extent that mortgage originators or real estate agents could create, manipulate, and intensify the psychological and economic environment of racial change, or increase the mortgage basis of the property through bribery of FHA officials, inflated appraisals, or falsified credit reports, they could increase the profits of loan origination.[50] Such abuses scandalized the FHA programmatic reforms.[51]

The availability of FHA-insured mortgages significantly altered the financial medium for real estate transfers in transitional neighborhoods. Few would argue that compared to the installment contract, the black buyer was relatively worse off despite the programmatic abuses and fast foreclosure processing of delinquent FHA mortgagors.[52] Nevertheless, the availability of FHA-insured mortgage finance did not alter the two fundamental characteristics of the dual housing market in Chicago: restricted black access to white suburban housing markets and uncertain expectations of neighborhood change held by white sellers, mortgage lenders, and brokers. These factors allowed intermediaries to earn large profits at the expense of both white seller and black buyer. The FHA policy change was notably an inner-city mandate; FHA

programs in Chicago were not used to facilitate suburban open housing.[53]

The anger of white inner-city community groups in the early and mid-seventies over the active lending role of FHA and its programmatic abuses focused on the "disinvestment" of conventional lenders. For the first time there was a precise, quantitative measure of the perceived capital losses sustained in the process of racial transition. FHA discount points, clearly recorded in the mind of the seller and on the mortgage document of the buyer, provided the former with an index of individual loss independent of the relationship between sale price and city-wide property values. Sellers were "willing" to pay these points since there was no alternative financing for the buyer and they feared greater losses if they delayed the sale.[54]

The presence of conventional mortgage money, more than anything else, has come to symbolize future investment potential and a stable real estate market. At least one writer has argued that the availability of alternative conventional credit would reduce the price effects from FHA points and the potential for origination profits.[55] However, in the absence of an open housing market, "discriminatory" origination profits would still exist. If conventional lenders perceived additional risks of lending in transitional neighborhoods, they too would charge loan origination points. However, the incidence of the burden would differ; as mortgagor, the black buyer would generally pay these costs. Unlike the price effects with FHA mortgage finance, the costs would not be absorbed into a higher sale price, but would be payable at the time the conventional loan was written.

Lessons for Public Policy

The analysis of installment contract transactions presented in this study detailed a frequently noted, but rarely documented, pattern of real estate transactions in inner-city transitional neighborhoods where mortgage money was unavailable. The characteristics of speculative behavior and the terms of contract sales testify to the vulnerability of buyers in such markets. First-time contract homebuyers were particularly vulnerable to the sale tactics of speculators because either racial discrimination, low income, or both placed them in an inferior bargaining position.

Installment contracts were and continue to be legitimate instruments for the transfer of property, particularly high-risk sales. As such they are likely to remain a characteristic of real estate markets where mortgage money is not available but where the housing stock is suitable for non-professional resident owner-occupancy. A real estate investor continues to benefit from selling on contract as opposed to renting because of the reduced maintenance, tax and insurance liability and to the extent he can capitalize on the desire for homeownership and secure a downpayment in excess of the rental security deposit. Indeed, it would not be at all surprising to find an increase in the incidence of contract sales and other types of private financing transfers if there is a credit vacuum in the low-income homeownership market due to the revisions of federal subsidy programs for low-income homeownership. Nevertheless, from the seller's perspective, contract sales are a substitute for rental arrangements only in those states where the foreclosure process is rapid and in-

expensive.

In the absence of discrimination, the major inequity of installment sales is the poor allocation between rights and risks. The "windfall profit" to the seller in the event the buyer defaults increases over time while the risk to the seller decreases. All legal reforms of installment sales are within the province of the individual states. As evidenced by the relative differences between mortgages and installment contracts in California and Maryland compared to Illinois,[56] there is a wide range in which to redefine the minimal rights of the contract buyer in Illinois. Legislative reformation of contract transactions in Illinois should increase the institutional protection of the buyer commensurate with his increased equity accumulation. Without destroying the extra protection afforded by installment contracts for high-risk sales, the rights of the buyer should be safeguarded through provisions for mortgage-like protection as soon as the buyer has accumulated a "substantial" investment and the risk to the seller has been reduced.

Institutional safeguards, however, are not a substitute for consumer knowledge. The contract buying experience revealed that buyers had a poor understanding of homebuying; many consulted lawyers but not on the value of the property. First-time buyers were unfamiliar with home-buying procedures, criteria for property selection and professional assistance (legal advice, appraisals, repair estimates), price negotiation and the mechanics of loan amortization. Funding for buyer counseling should be available but directed toward assistance for local consumer advocacy organizations, fair housing organizations,

non-profit housing sponsors, and neighborhood services groups, as a counterforce to the unequal seller-buyer bargaining relationship which develops in declining neighborhoods and those transition neighborhoods dominated by speculative real estate activity.

Unfortunately, the black contract market did not develop independent of racial discrimination. Policies to increase buyer safeguards in installment sales transactions and buyer knowledge of homebuying only affect the superficial manifestations of discriminatory housing burdens. Insomuch as the pattern of Chicago's segregated residential market is characteristic of other urban areas, this case study provides an example of how market barriers create opportunities for intermediaries to arbitrage supply constraints facing the black household buying outside established black residential areas.

The pattern of speculative behavior at the interface between white and black housing markets in Chicago suggests that black residential expansion continues to be funneled into selected neighborhoods, despite the availability of FHA-insured mortgage finance. Funneling results from the economic incentives present for regular housing market actors (real estate brokers and lending institutions) to discriminate by providing services on a segregated basis. Since established local housing market actors are reluctant to initiate interracial sales, new market actors emerge as dominant forces. This results in a turnover of real estate brokers and financial institutions in transitional neighborhoods. Price differentials between white and black markets, concentrated at the point of transition, result from restricted access to the larger white market. Policies aimed at

eliminating the discriminatory component of the arbitrage profit must focus on these barriers to an open market.

If in the past restrictive actions were highly organized and open, the techniques today are more subtle and harder to detect. Discrimination often takes the form of restrictions or distortions in the information given to black households. Much of the information provided by sellers and real estate brokers is either subjective or unrecorded. This combination makes enforcement of open-housing legislation costly, difficult and of limited impact in affecting the broad forms of market discrimination.[57] Research must be directed at the search process of black households to determine the most effective means to increase accessibility without excessive search costs. Anti-discrimination policies must focus on increasing the flow of available market information and thereby eliminating the economic incentives of realty institutions to discriminate. Policies designed to increase access of minority brokers to multiple listing services will, as one researcher noted, change the incentives facing brokers since white buyers and sellers presumably could no longer avoid brokers who sold to blacks in white neighborhoods.[58]

The main controversy concerning housing finance in urban areas today revolves around allegations of the lack of conventional sources of mortgage credit in older neighborhoods. Unfortunately, race still appears to play a part in the loan decision. In a recent study of this problem, Schafer has concluded that in the State of New York race is still a factor in differential access to housing credit.[59]

Since 1966, the availability of FHA finance has brought institutional mortgage credit to inner-city transitional neighborhoods. The qualitative difference between contract sales and FHA mortgage finance is significant; the abuses in the implementation of the program do not negate the importance of the policy change. To the extent that black suburban housing choices are limited and new construction continues to play a small part in the supply of units to the black market, transfers of existing homes from the white to black market will continue to shape the price and transaction characteristics of housing available to blacks. Whether, with FHA-insured mortgages, the premium required by intermediaries to transfer these units between markets is greater than, less than, or equal to the premium required with contract finance is a subject for future research. However, because the risk of non-payment is removed from the purchase arrangement, one would expect that FHA-insured mortgage availability would represent a distinct improvement over contract finance.

APPENDIX

APPENDIX TABLE 1

Standardized b-values: Credit Arbitrage Model

Independent Variable	West Side Submarket	South Side Submarket
BLD	.075	.023
NAPTATP	-.018	.147
MD60	.010	.187
SUB1	-.098	.050
SUB3	-.116	-.050
ET1	.139	-.015
ET3	-.011	-.089
LS	-.072	-.024
BURDEN	.437	.349
KDP	-.175	-.062
KTERM	.567	.430
TIME2	-.124	-.176
TIME3	-.453	-.236
TIME4	-.122	.136

NOTE: The standardized b-value adjusts for the differences in measurement units of the independent variables. It is obtained by multiplying the regression coefficient by the ratio of the standard deviation of the independent variable to that of the dependent variable.

APPENDIX TABLE 2

Definition of Variables in Contract Price Model

CONPRICE	Installment contract sale price in 1957-59 constant dollars.
LROOMS	Number of rooms in the structure in natural logarithms.
BLDLR	LROOMS*BLD where BLD = dummy variable. 1 = multi-flat structure; 0 = otherwise. The coefficient, when added to LROOMS, measures the additional price effect of rooms if the structure is a multi-flat building.
NAPTATP	Number of apartments in the structure at the time of the contract sale.
CONSTM	Dummy variable. 1 = construction type of building, frame; 0 = construction type of building, masonry.
OCCP	Percent owner-occupied units in census tract (1960).
SUB1	Dummy variable. 1 = less than 10 percent substandard housing units in census tract; 0 = otherwise (1960).
SUB3	Dummy variable. 1 = more than 20 percent of housing units in census tract substandard; 0 = otherwise (1960). The excluded category for substandard housing is 10 - 20 percent.
ETTIME12	Dummy variable. 1 = early transition neighborhood (Penetration, Invasion), sale during market period 1 or 2; 0 = otherwise.
ETTIME3	Dummy variable. 1 = early transition neighborhood, sale during market period 3; 0 = otherwise.
ETTIME4	Dummy variable. 1 = early transition neighborhood, sale during market period 4; 0 = otherwise.
LT	Dummy variable. 1 = late transition neighborhood (Late Consolidation, Piling Up); 0 = otherwise. The excluded variable is neighborhood in intermediate stage of transition (Early Consolidation, Consolidation).
CTY60	1960 median family income of census tract in 1957-59 constant dollars.

APPENDIX TABLE 2, continued

KDP	Percent contract downpayment.
KTERM	Term-to-maturity of contract, years.
LS	Dummy variable. 1 = large-scale seller in west side market; 0 = small-scale seller in west side market.
CANDG	Dummy variable. 1 = large-scale seller, Peck or Master, south side market; 0 = other large-scale seller and all small-scale sellers in south side market.
TIME2	Dummy variable. 1 = sale occurred between 1959-1961; 0 = otherwise.
TIME3	Dummy variable. 1 = sale occurred between 1962-1965; 0 = otherwise.
TIME4	Dummy variable. 1 = sale occurred between 1966-1968; 0 = otherwise.
	Excluded time category is 1956-1958.

APPENDIX TABLE 3

Means and Standard Deviations of Variables in the Contract Price Regression Model

Variable	West Side Submarket		South Side Submarket	
	Mean	Standard Deviation	Mean	Standard Deviation
CONPRICE ($)	20,247	4,771	17,778	6,478
Building Characteristics				
LROOMS (ln)	2.46	.31	2.18	.37
BLDLR (ln)	2.19	.91	1.28	1.24
NAPTATP	1.32	.91	.91	1.17
CONSTM (yes = 1)	.04	.20	.59	.49
Neighborhood Characteristics				
OCCP	22.00	7.47	30.29	13.78
SUB1 (yes = 1)	.70	--	.58	--
SUB3 (yes = 1)	.19	--	.18	--
ETTIME12 (yes = 1)	.38	--	.34	--
ETTIME3 (yes = 1)	.26	--	.11	--
ETTIME4 (yes = 1)	.03	--	.06	--
LT (yes = 1)	.05	--	.12	--
CTY60 (hundred dol.)	55.46	6.68	56.17	7.53
Risk-Related Characteristics				
KDP (%)	5.83	3.37	5.04	3.60
KTERM (years)	17.95	4.29	17.92	4.38
Other Characteristics				
LS (yes = 1)	.55	--	.80	--
TIME2 (yes = 1)	.40	--	.35	--
TIME3 (yes = 1)	.41	--	.31	--
TIME4 (yes = 1)	.09	--	.15	--
Number of observations	276		142	

APPENDIX TABLE 4

OLS Regression Model of Installment Contract Price

Independent Variable	West Side Submarket		South Side Submarket	
	Coefficient	(t-value)	Coefficient	(t-value)
Building Characteristics				
LROOMS (ln)	6,172.86	(6.11)	12,135.53	(7.62)
BLDLR (ln)	855.16	(2.89)	-1,236.53	(-2.96)
NAPTATP	876.73	(3.76)	893.07	(2.19)
CONSTM	-1,751.13	(-2.45)	-2,707.42	(-4.07)
Neighborhood Characteristics				
OCCP	-3.87	(-0.13)	-52.30	(-1.50)
SUB1	1,079.33	(2.23)	1,320.87	(1.70)
SUB3	1,173.22	(1.96)[c]	898.77	(0.80)
ETTIME12	314.28	(0.67)	844.03	(1.00)
ETTIME3	1,108.58	(2.15)[c]	708.33	(0.63)
ETTIME4	-79.16	(-0.07)	1,105.62	(0.68)
LT	-2,014.88	(-2.64)[a]	-193.05	(-0.19)
CTY60 (hundred dol.)	20.64	(0.56)	128.83	(2.10)
Risk-Related Characteristics				
KDP	3.14	(0.07)	356.09	(3.30)[b]
KTERM	261.89	(7.29)[a]	226.36	(2.98)[a]
Other Characteristics				
LS	213.40	(0.75)	2,651.00	(3.39)[a]
TIME2	217.52	(0.42)	-751.49	(-0.87)
TIME3	-1,912.47	(-2.65)	-1,531.11	(-1.30)
TIME4	-4,011.88	(-4.76)	-3,538.87	(-2.62)
Intercept	-4,041.74	(-1.57)	-19,976.60	(-4.78)
Degrees of Freedom	257		123	
R^2	.794		.777	
F-Ratio	52.92		23.74	
Prob > F	.0001		.0001	

NOTE: Table notes indicate significance of t-ratios for eight coefficients under simultaneous statistical testing for overall level of significance (ETTIME12, ETTIME3, ETTIME4, LT, KDP, KTERM, SUB3, LS).

a. .05 one-tailed test
b. .05 two-tailed test
c. .10 one-tailed test
d. .10 two-tailed test

APPENDIX TABLE 5

Standardized b-values: Expected Present Value Net Profit Model

Independent Variable	West Side Submarket	South Side Submarket
MTGLVR	.386	.640
NEGEQ	.365	-.094
SECMTG	.116	.117
KDP	.017	.244
SUB1	-.053	-.049
SUB3	.082	.092
MD60	-.181	.042
BLD	.177	.100
ET1	.052	.063
ET3	.051	.015
LS	.107	CANDG -.175
TIME2	-.199	.002
TIME3	-.272	.014
TIME4	-.041	.209

See Note, APPENDIX TABLE 1.

NOTES

Notes: Chapter 1

1. Allan H. Spear, *Black Chicago: The Making of a Negro Ghetto 1990-1920* (Chicago: University of Chicago Press, 1967), pp. 26-27.

2. A. H. Pascal, *The Economics of Housing Segregation,* RAND Corporation Memorandum RM-5510-RC (Santa Monica: RAND Corporation, November 1967), pp. 11, Table II.2, p. 12. These "mixed" areas almost always represent a temporary stage before the areas become almost exclusively negro residential areas. David Wallace, "Residential Concentration of Negroes in Chicago" (Ph.D. dissertation, Department of Regional Planning, Harvard University, 1953).

3. David McEntire, *Residence and Race* (Berkeley: University of California Press, 1960), p. 71.

4. See Stanley Leiberson, *Ethnic Patterns in American Cities* (Glencoe, Ill.: Free Press of Glencoe, 1963); Karl E. Taeuber and Alma F. Taeuber, "The Negro as an Immigrant Group: Recent Trends in Racial and Ethnic Segregation in Chicago," *American Journal of Sociology* 69 (January 1964), pp. 374-82.

5. Pascal, "The Economics of Housing Segregation;" Karl E. Taeuber and Alma F. Taeuber, *Negroes in Cities: Residential Segregation and Neighborhood Change* (Chicago: Aldine Publishing Co., 1965).

6. Homer Hoyt, *One Hundred Years of Land Values in Chicago* (Chicago: University of Chicago Press, 1933), p. 216 as cited by Pascal, "The Economics of Housing Segregation," p. 24.

7. *Chicago Real Estate Board Bulletin* 25 (April 18, 1917) as cited by Rose Helper, *Racial Policies and Practices of Real Estate Brokers* (Minneapolis: University of Minnesota Press, 1969), p. 225.

8. Ibid.; Thomas Lee Philpott, *The Slum and The Ghetto: Neighborhood Deterioration and Middle-Class Reform, Chicago 1880-1930* (New York: Oxford University Press, 1978), p. 163.

9. Philpott, *The Slum and the Ghetto*, pp. 179,185.

10. St. Clair Drake and Horace R. Cayton, Black Metropolis: A Study of Negro Life in a Northern City, Torchbook edition, revised and enlarged (New York: Harper Torchbooks, 1962), p. 184.

11. Duncan and Duncan, The Negro Population of Chicago, p. 300; Local Community Fact Book Chicago Metropolitan Area, 1960, Evelyn M. Kitagawa and Karl E. Taeuber, eds. (Chicago: Chicago Community Inventory, University of Chicago, 1963).

12. Pierre de Vise, Chicago's Widening Color Gap, Interuniversity Social Research Committee, Report No. 2 (Chicago: ISRC, 1967), p. 17; Duncan and Duncan, The Negro Population of Chicago, p. 95.

13. Duncan and Duncan, The Negro Population of Chicago, p. 79.

14. deVise, Chicago's Widening Color Gap, p. 17.

15. See Philpott, The Slum and The Ghetto, Chapter 7; Drake and Cayton , Black Metropolis, pp. ii-iii; note 8, Chapter 3, infra.

16. White unemployment in Chicago was substantially lower and income higher in both periods. White unemployment declined from 13.5 percent to 3.9 percent between 1940 and 1960; median family income for the total population was $3,956 in 1950 and $6,738 in 1960. U. S. Department of Commerce, Bureau of the Census, Census of Population: 1940, Vol. 1, Part 1 (Washington, D. C.: GPO, 1943), Table 17; idem, Census of Population: 1950, Vol. 1, Part 15 (Washington, D. C.: GPO, 1953), Tables 37, 66; idem, Census of Housing: 1960, Vol. 1, Part 15 (Washington, D. C.: GPO, 1963), Tables 73, 76, 77. It is not possible to present income changes over the 1940-1950 decade since the income figures for 1940 and 1950 are not comparable. Otis D. Duncan and Beverly Duncan, The Negro Population of Chicago: A Study of Residential Succession (Chicago: University of Chicago Press, 1957), p. 75.

17. Chicago Commission on Human Relations, The Growing Negro Middle-Class in Chicago: A Research Report (Chicago: CCHR, September 1962).

18. Purchase money mortgages are mortgages typically granted by the seller in order to facilitate the sale; the buyer obtains the deed and makes payments to the seller. It is not uncommon for privately negotiated mortgage loans to consist of two or three mortgages, with each junior mortgage lien (its claim is subordinate to the first mortgage and any others before it) carrying a deeper discount. These loans are discounted to reflect the greater risk of these subordinate, risky liens. By discounting the loans rather than raising the interest payments, lenders minimize their front-end cash commitment. The "kited" mortgage has a face value greater than the market value of the property due to the fact that the usury laws of the state, under certain conditions, limit the amount of interest that can be charged on the loan. Balloon mortgages are incompletely amortized mortgages which provide for a lump sum payment by the buyer at the term of the loan. See George Sternlieb and Robert W. Burchell, Residential Abandonment: The Tenement Landlord Revisited (New Brunswick: Center for Urban Policy Research, 1973), Chapter 6.

19. Chicago Commission on Race Relations, The Negro in Chicago (Chicago: University of Chicago Press, 1922), p. 201.

20. Upton Sinclair, The Jungle (New York: Signet Classics, 1960), p. 59.

21. Mark Satter, "Land Contract Sales in Chicago: Security Turned Exploitation," Chicago Bar Review 39 (1958), p. 262.

22. U. S. Government Office Memorandum, DSCUR and HHFA, George B. Nesbitt and B. T. McGraw to Gordon Howard, "Notes on Racial Aspects of Housing Market Analysis," March 12, 1954, Library of the U. S. Department of Housing and Urban Development, Washington, D. C. (hereinafter cited as Nesbitt memo); Commission on Race and Housing, Where Shall We Live?, Report of the Commission (Berkeley: University of California Press, 1958); U. S. Commission on Civil Rights, Report, 1959 (Washington, D. C.: GPO, 1959), pp. 343-80.

23. McEntire, Residence and Race, p. 92; Chester Rapkin and William G. Grisby, The Demand for Housing in Racially Mixed Areas

(Berkeley: University of California Press, 1960), p. 87.

24. Duncan and Duncan, The Negro Population of Chicago; Beverly Duncan and Philip M. Hauser, Housing a Metropolis -- Chicago (Glencoe: Free Press of Glencoe, 1960); McEntire, Residence and Race.

25. White homeownership in Chicago increased from 25.8 percent in 1940 to 32.9 percent in 1950 and 39.0 percent in 1960. U. S. Department of Commerce, Bureau of the Census, Census of Housing: 1950, Vol. 1, Part 1 (Washington, D. C.: GPO, 1953), Table 3; idem, Census of Housing: 1960, vol. 1, Part 1 (Washington, D. C.: GPO, 1963), Tables 9, 15, 23.

Whether by choice or necessity, blacks have resided in those areas where there are relatively few units appropriate for owner-occupancy. When this factor is accounted for, the 1940-1950 discrepancy between white and non-white homeownership is reduced. Duncan and Duncan, The Negro Population of Chicago, pp. 80-81.

26. Stanley W. Kadow, "Observations on the Minority Group Market," Insured Mortgage Portfolio 19 (Summer 1954), pp. 16-18; Nesbitt memo, p. 5.

27. McEntire, Residence and Race, p. 236; Chicago Commission on Human Relations, Mortgage Availability For Non-Whites in the Chicago Area: A Report, (Chicago, CCHR, April 1963).

28. McEntire, Residence and Race, pp. 224-27. The finance problem in ghetto areas was generally viewed by industry spokesmen as a function of the poor quality of property per se, not race discrimination in the locational choice of housing.

29. Satter, "Land Contract Sales in Chicago;" E. Frederick Schietinger, Racial Succession and Changing Property Values in Chicago (Ph.D. dissertation, University of Chicago, 1953, published by the Committee on Education, Training and Research in Race Relations of The University of Chicago for the Council Against Discrimination of Greater Chicago, June 1953); Jack Rothman, "The Ghetto Makers," The Nation 193

(October 7, 1961), pp. 222-25, in *Race and Poverty: The Economics of Discrimination*, John F. Kain, ed. (Englewood Cliffs, N.J.: Prentice-Hall, Inc., 1969), pp. 122-27.

30. Robert Schafer, "Discrimination in Housing Prices and Mortgage Lending," Working Paper 59, Joint Center for Urban Studies of MIT and Harvard University (Cambridge: JCUS, June 1979), pp. 5-6; *Jones v. Mayer*, 392 U. S. 409, (1968).

31. *Jones v. Mayer*, 392 U. S. 409, 88 S. Ct. 2186, p. 2189.

32. Nesbitt memo, pp. 4-5.

33. "Discriminatory Housing Markets, Unconscionability and Section 1988: The *Contract Buyers League* Case," *Yale Law Journal* 80 (1971), pp. 526-30.

34. Ray Marshall, "The Economics of Racial Discrimination: A Survey," *Journal of Economic Literature* 12 (September 1974), p. 861.

35. "Complaint," *Contract Buyers League v. F & F Investment*, No. 69 C15, filed on January 6, 1969, U. S. District Court, Northern Illinois, Eastern Division, Chicago. Pursuant to Judge Will's decision to dismiss the orgnaization as a plaintiff, the heading carried the name of the League chairman, a plaintiff-buyer. The case heading was subsequently changed again when this person made an out-of-court settlement with his seller; the case went to trial under the title, *Wells v. F & F Investment*.

36. *Contract Buyers League v. F & F Investment*, 300 F. Supp. 210 (N. D. Ill. 1969), pp. 215-16.

37. "Discriminatory Housing Markets," pp. 522-26.

38. Jurors' notes and comments on the "Contract Buyers Case," *Wells v. F & F Investment*, Chicago, unpublished, files of the Contract Buyers League, November 3, 1975 - April 16, 1976.

39. *Clark v. Universal Builders, Inc.*, No. 69 C15 (N. D. Ill., filed Jan. 20, 1969).

40. *Clark v. Universal Builders, Inc.*, 501 F. 2d 324 (7th Cir., 1974), cert. denied, 95 S. Ct. 657 (1974).

41. Ibid., pp. 330, 334.

42. Ibid., p. 331.

43. Contract Buyers League, "The History of the Contract Buyers League" (Chicago: The League, undated); The Gamaliel Foundation, "Progress and Prospects" (Chicago: Gamaliel Foundation, revised July 1969). An excerpt from this publication can be found in G. Lefcoe, Land Finance Law (New York: Bobbs-Merrill, Inc., 1969), pp. 208-14. Also see James Allen McPherson, "In My Father's House There Are Many Mansions -- And I'm Going to Get Me Some of Them Too," Atlantic Monthly 229 (April 1972), pp. 52-82; Alan Boles, "The Contract Buyers League: A Personal Evaluation," Yale Review of Law and Social Action 1 (Spring 1970), pp. 85-7; Gregory Colvin, "The Contract Buyers League: The Legal Listening Process," Yale Review of Law and Social Action 1 (Spring 1970), pp. 88-91.

44. Garino, "Slum Clearance," The Wall Street Journal, January 2, 1969, p. 12; "Home Buyers Fight Contract Racket," The Washington Post, August 4, 1969, p. 1; "Chicago's Quiet Slum Revolt," America 350 (October 25, 1969); Alan Boles, "Black Homeowning," The New Republic 7 (December 13, 1969).

In the winter and early spring of 1970, the League organized a contract payment strike designed to pressure sellers into renegotiating contracts. The payment strike finally brought about mass evictions of its defaulting members. Complete coverage is reported in the Chicago newspapers: "Crowd Foils South Side Eviction," Chicago Sun-Times, Jan. 30, 1970, p. 3; "Crowd Thwarts Sheriff in a West Side Eviction," Chicago Sun-Times, March 24, 1970, p. 5; "Twelve More Evicted, Crowd Stones Police," Chicago Today, March 31, 1970, p. 3; "Stop Evictions!," Chicago Daily Defender, April 1, 1970, p. 1; "Snowstorm Delays Evictions of More CBL Families," Chicago Sun-Times, April 2, 1970; p. 1; "Daley Will Mediate CBL Dispute Tuesday," Chicago Sun-Times, April 7, 1970, p. 5; "Agreement is Reached on Evictions," Chicago Tribune, April 9, 1970, p. 1; "Sheriff Evicts CBL Chief," Chicago Daily News, April 21, 1970, p. 1; "South Side Families

Evicted," "24 Jailed in Rock-Throwing," Chicago Sun-Times, April 28, 1970, p. 7; Lindstead, "CBL Chief Evicted, But Confident," Chicago Daily News, April 25-26, 1970, p. 1; cited by "Discriminatory Housing Markets," footnote 12, p. 521.

45. Graham, "U. S. Backs Negro Suit to Recoup 'Blockbusting' Profit in Chicago," The New York Times, March 29, 1969, p. 1; Kohlmeier, "Nixon Bid to Aid Blacks: Negroes Could Sue Home Dealers, Stores for Sales Bias Under Plan," The Wall Street Journal, March 31, 1969, p. 26, cited by "Discriminatory Housing Markets," footnote 9, p. 578.

46. For a comprehensive analysis of these models, see John Yinger, "Prejudice and Discrimination in the Urban Housing Market," Discussion Paper 77-9, Department of City and Regional Planning, Harvard University (Cambridge: DCRP, August 1977).

47. Ann B. Schnare, Externalities, Segregation and Housing Prices (Washington, D. C.: The Urban Institute, 1974), pp. 3-7, cited by Schafer, "Discrimination in Housing Prices and Mortgage Lending," p. 4.

48. Gary S. Becker, The Economics of Discrimination (Chicago: University of Chicago Press, 1957); Martin J. Bailey, "Note on the Economics of Residential Zoning and Urban Renewal," Land Economics 35 (August 1959), pp. 288-92.

49. Pascal, The Economics of Housing Segregation; James T. Little, "Housing Market Behavior and Household Mobility Patterns in Transition Neighborhoods," Working Paper HMS 1, Institute for Urban and Regional Studies (St. Louis: Washington University, Institute for Urban and Regional Studies, October 1973).

50. Yinger, "Prejudice and Discrimination in the Urban Housing Market," pp. 7-23.

51. John F. Kain and John M. Quigley , Housing Markets and Racial Discrimination (New York: Columbia University Press for The

National Bureau of Economic Research, 1975), chapters 2, 3; John Quigley, "Racial Discrimination and the Housing Consumption of Black Households," in Patterns of Racial Discrimination, pp. 121-37.

52. Schafer, "Discrimination in Housing Prices and Mortgage Lending," p. 5. For Chicago, see Drake and Cayton, Black Metropolis, chapter 8; Philpott, The Slum and the Ghetto, chapters 5-8. For the U. S. in general, see Charles Abrams, Forbidden Neighbors (New York: McGraw Hill, 1955), pp. 227-37; Robert C. Weaver, The Negro Ghetto (New York: Harcourt, Brace and Co., 1948); Commission on Race and Housing, Where Shall We Live?.

53. Kain and Quigley, Housing Markets and Racial Discrimination, p. 68.

54. Schafer, "Discrimination in Housing Prices and Mortgage Lending."

55. William Brink and Lou Harris, "Supplementary Statistical Tables," in Race and Poverty, pp. 144-45, as cited by Schafer, "Discrimination in Housing Prices and Mortgage Lending," pp. 6-7.

56. Hal M. Freeman, "Desegregation of Chicago Suburbs," Journal of Intergroup Relations 4 (Autumn 1965), p. 267. This article also reported the same conclusion from a study analyzing the experience of negros who moved into apartment buildings with predominantly white occupancy. "Experiences of Selected Negro Families in Securing and Living in Apartments in Buildings with Predominantly White Tenancy," a report by the Committee on Civil Rights in Metropolitan New York, Inc., March 1965, p. 11.

57. Yinger, "Prejudice and Discrimination in the Urban Housing Market."

58. John F. McDonald, "Housing Market Discrimination, Homeownership, and Savings Behavior: Comment," American Economic Review 64 (March 1974), p. 228.

59. E. Frederick Schietinger, "Racial Succession and Changing Property Values in Residential Chicago," in Contributions to Urban

Sociology, E. W. Burgess and D. J. Bogue, eds. (Chicago: University of Chicago Press, 1963).

60. Albert J. Mayer, "Russel Woods: Change Without Conflict; A Case Study of Neighborhood Racial Transition in Detroit," in Housing and Minority Groups, Nathan Glazer and David McEntire, eds. (Boulder: University of Colorado Press, 1960), chapter 4; U. S., Congress, House, Committee on Banking and Currency, Second Mortgages, Land Sale Contracts, and Other Financing Devices Employed in Conventional Mortgage Lending, 86th Cong., January 1960.

61. Because title does not change ownership in land contract sales, these sales are rarely recorded and, therefore, deed records do not include the universe of sales transactions. The extent to which contract sales are characteristic of sales in racially transitional neighborhoods will lead to a sample bias in those studies utilizing deed transactions. Not only does this non-recording feature of contract sales underestimate transaction volume, it also gives a biased distribution of the type of seller involvement. Without corresponding data on the race of the buyer, it is unclear which sale (combination of sales) is being analyzed -- the white seller to white speculator, white speculator to black buyer, or white seller to black buyer. The latter, direct type of sale was infrequent in transitional neighborhoods.

Because the transaction prices between white seller and speculator and between speculator and black buyer for the identical parcel of property were radically different, a sample of recorded transactions which is biased because of the omission of the speculator-black contract buyer type of transaction is likely to significantly misrepresent the price dynamics in racially changing neighborhoods. The study conducted by Martin J. Bailey, "Effects of Race and Other Demographic Factors on the Values of Single-Family Homes," Land Economics 42 (May 1966), was particularly susceptible to this type of methodological bias because installment contract sales were common during the time frame of the study. Other later studies of Chicago which were based

on samples drawn from recorded deed transactions include: David H. Karlen, "Racial Integration and Property Values in Chicago," Urban Economics Report No. 7, University of Chicago, April 1968; Brian J. L. Berry, "Ghetto Expansion and Single-Family Housing Prices: Chicago, 1968-1972," Journal of Urban Economics 3 (1976), pp. 397-423.

62. To examine price relationships in these neighborhoods it is necessary to determine sales price; this price can be secured from either the sales document or by estimating sales price as evidenced by tax stamps affixed to recorded deeds. Most studies have relied on the latter process under the assumption that such estimates were valid, since federal law required that all money exchanged in the sale and all mortgages or other liens placed on the property in connection with the sale to be subject to the tax. Therefore, although there is a legal lower limit on the stamps affixed, it may be to the buyer's advantage to affix additional stamps in order to give the impression to future buyers, lending institutions, appraisers or assessors that the property was worth more than the actual sales price. In Chicago, it was common knowledge that speculators purchasing in racially transitional neighborhoods did so inflate the tax stamp prices. See note 9, Chapter 2, infra. for an estimate of the inflated sales price component.

63. Hoyt, One Hundred Years of Land Values in Chicago, pp. 120-22; U. S. Federal Housing Administration, Underwriting Manual (Washington, D. C.: GPO, 1938), paragraph 937; idem, Underwriting Manual, 1947, paragraph 1320(2); Duncan and Duncan, The Negro Population of Chicago, pp. 83-4; Duncan and Hauser, Housing a Metropolis -- Chicago, pp. 203-4; Taeuber and Taeuber, Negroes in Cities, p. 25; Becker, The Economics of Discrimination; Bailey, "Effects of Race and Other Demographic Factors." Cited by Brian J. L. Berry, "Ghetto Expansion and Housing Price," paper prepared for C.U.E. Conference on Economics of the Ghetto held at the University of Wisconsin, May 1975, Draft -- February 1975, pp. 4-14.

64. See in particular Richard Muth, "Residential Segregation and Discrimination," in Patterns of Racial Discrimination, Vol. 1: Housing, George vonFurstenberg, A. R. Horowitz, and Bennett Harrison, eds.

(Lexington, Mass.: Lexington Books, 1974), pp. 107-19; Paul N. Courant, "Economic Aspects of Racial Prejudice in Urban Housing Markets"(Ph.D. dissertation, Princeton University, 1974).

65. Chicago Commission on Human Relations, Selling and Buying Real Estate in a Racially Changing Neighborhood (Chicago: CCHR, 1962); Rothman, "The Ghetto Makers," in Race and Poverty.

66. See Karen Orren, Corporate Power and Social Change (Baltimore and London: Johns Hopkins University Press, 1974).

67. Freeman, "Desegregation of Chicago Suburbs," p. 263.

68. D. S. Projector, et al., "Survey of Changes in Family Finances," Federal Reserve Technical Paper (Washington, D. C.: Board of Governors of the Federal Reserve System, 1968), cited by Kain and Quigley, Housing Markets and Racial Discrimination, p. 150.

Notes: Chapter 2

1. "Discriminatory Housing Markets, Unconscionability and Section 1988: The Contract Buyers League Case," Yale Law Journal 80 (1971), footnote 11, p. 520.

2. Letter from F. E. Tripp, Tax Technician, Internal Revenue Service, January 19, 1967, cited by Frank Dotson , "The Development of a Numerical Scoring System for Evaluating Mortgage Loan Delinquency Risk" (Ph.D. dissertation, University of Southern California, 1968), p. 31, footnote 1.

3. "Discriminatory Housing Markets, p. 520, footnote 11.

4. Greg Colvin, "The Provision for Mortgage Conversion and Title Conveyance in Installment Contracts For the Sale of Residential Property to Blacks in Chicago," unpublished student law school paper, April 10, 1970, files of the Contract Buyers League, Chicago.

5. John M. Wetmore, Chief Economist, Mortgage Bankers Association of America, letter to author, April 14, 1977.

6. John Mixon, "Installment Land Contracts: A Study of Low Income Transactions, With Proposals For Reform And A New Program To Provide Home Ownership in the Inner City," Houston Law Review 7 (May 1970), p. 536.

7. "Discriminatory Housing Markets," p. 524.

8. See "Case Comments: Curbing Exploitation in Segregated Housing Markets: Clark v. Universal Builders, Inc.," Harvard Civil Rights-Civil Liberties Law Review 10 (Summer, 1975), pp. 730-35 and Kenneth W. Dam, "The Economics and Law of Price Discrimination: Herein of Three Regulatory Schemes," University of Chicago Law Review 31 (1963), pp. 4-6.

9. By increasing the required number of federal revenue tax stamps, speculators inflated the recorded purchase price of properties in transitional neighborhoods. The inflated portion of the price averaged $4,000 or 35 percent of the real purchase price for a group of 254 properties in the installment contract sales sample. The recorded, inflated purchase price became extremely pronounced in 1966 and 1967, when FHA mortgage money became available in these inner-city neighborhoods.

Counsel for some defendant-sellers in the existing homes suit even stated during the trial that it was common custom for business operations in these communities to put more revenue stamps on the purchase price "in case a buyer checked." He defended this practice by stating that it would not be concealment from the savings and loan association granting a mortgage to the defendant-seller because the institution could always check directly with the defendant-seller and, anyway, the institution would not rely on revenue stamps. "They were very sophisticated. If anyone wanted to rely on stamps they were foolish or naive." "Transcript of Proceedings," Wells v. F & F Investment, No. 69 C15, U. S. District Court, Northern District of Illinois, Eastern Division, Chicago, p. 1072 (hereinafter cited as Wells v. F & F

Investment, TP).

10. Almost all speculators conducted property acquisition, financing and sale within the framework of bank land trust accounts which were identifiable only by trust number, and which were generally comprised of a single property. This format allowed the speculator to conceal his identity and the extent of his holdings and to limit his personal and business liability. Since it was the trust which entered into all transactions, and since its resources were limited to the assets of the single property, the liability of the beneficiary of the trust was limited.

11. As a gauge of both contract sales volume and professionalism, the two largest south side sellers, in partnership at the time (in 1954), revised the 1945 Geo. E. Cole standard legal blank (No. 74) for installment sales. In the new form they eliminated the clause prohibiting recording; however, not all sellers used this new form.

12. Baker v. F & F Investment, 420 F.2d 1191 (7th Cir. 1970); this district court's decision holding the suit to be a proper class action under Fed. R. Civ. Proc. 23(b)(3) is reported as Contract Buyers League v. F & F Investment, 300 F. Supp. 210 (N. D. Ill., 1969); Clark v. Universal Builders, Inc., 501 F. 2d 324 (7th Cir., 1974), cert. denied, 95 S. Ct. 657 (1974). This latter case is presently in litigation in an appeal trial.

13. As defined by the U. S. District Court for the Northern Division of Illinois, Eastern Division, the universe of contract sales comprised those "negroes who purchased homes (with less than seven flats) in the City of Chicago by means of installment sales contracts between January 1, 1952, and the date of filing the complaint from one of the named defendant sellers." "Answers to Interrogatories Regarding Random Sample," Contract Buyers League v. F & F Investment, U. S. District Court, Northern District of Illinois, Eastern Division, Chicago, November 15, 1971. It was derived from several sources: CBL records, responses from newspaper advertisements of the class action suit, tract book searches, searches of land trust files and an inter-

rogatory directed to the defendant sellers requiring them to list all residential properties which they had sold to negro purchasers on contract during the years covered by the suit. This universe of sales included properties held by sellers and by assignees who resold the property after the buyer forfeited the contract. Because the seller's inclusion in the suit as a defendant was dependent upon his identification by the contract buyer (and thus to the CBL), it is unlikely that the universe included all such sellers in the Chicago contract market. (There were hundreds of buyers who had no contact with the League becaue of fears of eviction. Jeffrey M. Fitzerald,"The Contract Buyers League: A Case Study of Interaction Between a Social Movement and the Legal System"(Ph.D. dissertation, Northwestern University, 1972), p. 435. However, the universe does include the largest speculators and those with continuous contract sales.

A second constraint on the size and coverage of the universe was the statute of limitations ruling which limited the plaintiff class to those buyers who had signed contracts after 1952 but whose contracts had not been terminated before January, 1964. (This opinion was issued sub nom Contract Buyers League v. F & F Investment, 300 F. Supp. 210, 223. Subsequently the case name was changed to Baker v. F & F Investment as the League was dismissed as a party, then to Wells v. F & F Investment after Baker withdrew as a plaintiff.)

As a consequence of the above two factors, the CBL universe underestimates the earliest period of contract sales, 1952-1962, and fails to cover all real estate investors engaging in contract sales. It will not include the following types of contract sales: (1) contract terminations before January, 1964, due to either complete payment to the seller or forfeiture of the contract, (2) contract properties liquidated by the seller through a discounted sale of the contract paper, and (3) installment sales by non-defendant speculators.

Various estimates of installment sales to black households between 1952 and 1968 have been much higher than the 2,600 figure. The CBL "universe" would be equivalent to one estimate for contract sales in North Lawndale alone (sales in this community represented

only one-fifth of the west side universe contracts).

James Allen McPherson, "In My Father's House There Are Many Mansions -- And I'm Going to Get Me Some of Them Too," Atlantic Monthly 229 (April 1972), p. 54; Mark J. Satter, "Land Contract Sales in Chicago: Security Turned Exploitation," Chicago Bar Record 39 (March 1958), p. 263; Chicago Commission on Human Relations, "Mortgage Availability in Racially Changing Areas," presented at public hearing of the Commission, August 9, 1967, cited by George Sternlieb, Robert Burchell and David Listokin, "The Urban Financing Dilemma," in U. S. Congress, Senate, Committee on Banking, Housing and Urban Affairs, Home Mortgage Disclosure Act of 1975: Hearing on S. 1281, 94th Cong., 1st sess., May 5-8, 1975, p. 560.

14. A non-proportional, stratified random sample of 482 installment sales was drawn in 1970 in the following manner: if a seller had less than 15 properties in the universe of sales, all of these sales were included in the sample; if a seller had more than 15 but less the 150 sales, 15 sales were randomly selected for the sample; if a seller had 150 sales or more, 10 percent were randomly selected for the sample. This sample was drawn prior to the verification of properties for inclusion in the universe. During the sample data collection process, 56 properties were found not to properly belong to the plaintiff class for one of two reasons. Either the property had not been sold by the defendant-seller to a negro purchaser or it was not a residential property (i.e., it was a church, store, large apartment building); 85 percent of these errors resulted from lists supplied by defendants . A sample of 419 sales remained; no further substitutions were made by the researchers to fill out the sample, since the use of the random sample was subsequently dropped from litigation strategy. There was insufficient information on other non-sample contract transactions to permit this researcher to draw a new sample or randomly fill out the sample for the missing number of cases.

The design of a non-proportional stratified sample was determined by researchers at Northwestern University in accordance with the

goals of litigation. The legal team had decided to use a random sample of installment contract transactions to establish the seller's liability in the class action case with a statistical analysis instead of multiple presentations of single transactions. The emphasis was on problems of the class as a whole and proof was directed at showing harm which was imposed upon the buyers because they fell within the class. Fitzgerald, "The Contract Buyers League," p. 434.

The thrust of the attack was concentrated upon the characteristics of the segregated housing market in Chicago, the nature of the contract market in which plaintiffs were "forced" to deal as a result of the segregated housing market, and a very comprehensive view of how the real estate investor operated and profited in toto. The random sample would be used by the lawyers to establish the liability of individual sellers (but not damages) and to describe the transaction process within the black market.

The sample was not designed to establish the economic dimensions of aggregate sales in the contract market but to provide a statistical profile of each defendant-seller. If the sample is used to evaluate the real market composition and behavior over time, it probably underestimates the effects of the large-scale sellers, since small-scale sellers were disproportionately sampled.

One could attempt to weight the sample values, but a problem remains with the determination of these population weights. Because of the nature of the universe (note 13, Chapter 2, supra), the distribution of sales held by speculators by community area, by sale year, in this universe may not be representative of the real population of installment sales. In light of the unknown real population weights, the data have been presented in unweighted form; possible biases are noted throughout the discussion. As a case study of economic and institutional relationships in installment sale transactions, however, these observations provide a representative sampling of individual seller behavior and emphasize the similarity of transaction procedures.

15. Otis D. Duncan and Beverly Duncan, The Negro Population of Chicago: A Study of Residential Succession (Chicago: University of Chicago Press, 1957), p. 95.

16. Interview in April, 1977, with a Hyde Park resident involved in the community resistance effort.

17. Pierre deVise, Chicago's Widening Color Gap, Interuniversity Social Research Committee, Report Number 2 (Chicago: ISRC, December 1967), p. 17.

18. David Wallace, "Residential Concentration of Negroes in Chicago" (Ph.D. dissertation, Department of Regional Planning, Harvard University, 1953), pp. 133, 144. See Thomas Lee Philpott, The Slum and the Ghetto: Neighborhood Deterioration and Middle Class Reform, Chicago 1880-1930 (New York: Oxford University Press, 1978), pp. 111-200, for an extended discussion of black residential expansion.

19. Brian J. L. Berry, "Short-Term Housing Cycles in a Dualistic Metropolis," in The Social Economy of Cities, Harold M. Rose, ed. (Beverly Hills: Sage Publications, Inc., 1975), Table 2, p. 171.

20. The data on new homes sold on installment contract comprise all those homes constructed by Universal Builders, Inc., pursuant to joint venture agreements with eight companies -- Rosewood, Larchmont, Hamilton, Lawson, Independence, Jarvis, Chatham, and South City Home Development -- under which they agreed to share sale net profits. Known as "land companies" because they purchased the land on which Universal built the homes, the separate corporate identities represented a formal business arrangement, rather than a real distinction, which was created to maximize the corporate surtax exemption. Officers, directors and employees of all companies were members of one family. Plaintiffs' Trial Exhibit(s) 352 A,D,E through K," Clark v. Universal Builders, Inc., No. 69 C115, U. S. District Court, Northern District of Illinois, Eastern Division, Chicago. No land company actively sold homes for the entire period of the south side operation. The bulk of each land company's sales occurred over a period of two to four

years, after which its sole business function became the financial management of monthly contract payments with occasional resales of forfeited contracts.

21. "Transcript of Proceedings," Clark v. Universal Builders, Inc., No. 69 C115, U. S. District Court, Northern District of Illinois, Eastern Division, Chicago, pp. 1272, 1291 (hereinafter cited as Clark v. Universal Builders, Inc.

22. "Plaintiffs' Trial Exhibit 407-B," Clark v. Universal Builders, Inc.

23. Clark v. Universal Builders, Inc., TP, pp. 4165, 5004-5.

24. "Plaintiffs' Trial Exhibit 471," Clark v. Universal Builders, Inc.

25. David McEntire, Residence and Race (Berkeley: University of California Press, 1960), p. 300.

26. Clark v. Universal Builders, Inc., TP, p. 1209.

27. The FHA, as directed by the Federal Seventh Circuit Court in the Baker v. F & F Investment suit, provided data to litigants on the location of properties with FHA-insured mortgages secured through Chicago's regional FHA insuring office between 1952-1969. Under the Court's ruling, plaintiffs had to show that FHA's discriminatory policies existed after August 11, 1965, five years prior to the filing of the complaint against it.

Several samples covering different time periods were drawn from the FHA insurance files: 1952-1959 (20 percent), 1960-1961 (87 percent), 1962 (20 percent), 1964 (100 percent) , 1965 - August 1966 (100 percent), 1964 - 1966 (100 percent). The population of files from which the samples were drawn comprised those loans still active in 1970. Because the actual average life of a mortgage runs about eight years, the samples are all biased in unknown, varying degrees against early loans. Turnover rates may differ geographically, particularly in light of racial transition. Therefore, inferences

based on geographical or temporal comparisons from these data must be qualified.

28. Charles Abrams, Forbidden Neighbors (New York: McGraw Hill, 1955), pp. 169- 81; R. A. Winkler, G. L. Bepko and P. Gelderman, "Some Aspects of the Negro Housing Market in the Chicago Area," in Open Occupancy vs. Forced Housing Under the Fourteenth Amendment: A Symposium on Anti-Discrimination Legislation, Freedom of Choice, and Property Rights in Housing, Alfred Avins, ed. (New York: Bookmailer, 1963), pp. 269-71; Chicago Commission on Human Relations, Mortgage Availability For Non-Whites in the Chicago Area: A Report (Chicago: The Commission, 1963); National Urban League, Mortgage Financing for Properties Available to Negro Occupancy (New York, NUL, 1954).

29. James M. Gavin, "Negroes Seek More Home Loan Sources," Chicago Tribune, November 4, 1962.

30. "Plaintiffs' Trial Exhibit 475," Clark v. Universal Builders, Inc.

31. See "Curbing Exploitation in Segregated Housing Market," Harvard Civil Rights-Civil Liberties Law Review, pp. 721-29 for a discussion of the profit liability standard.

32. "Plaintiffs' - Appellants' Brief," Clark v. Universal Builders, Inc., No. 72-1655, U. S. Court of Appeals for the Seventh Circuit, Chicago, p. 47. The gross markup for Deerfield was 21 percent, compared to 38 percent for UB's black installment sales. Ibid., p. 46.

33. Berry, "Short-Term Housing Cycles," Table 2, p. 171.

34. Fitzgerald, "The Contract Buyers League," p. 18.

35. U. S. Commission on Civil Rights, Housing: Hearings Held in Chicago, Illinois, May 5-6, 1959 (Washington, D. C.: GPO, 1959), pp. 868-69.

36. McPherson, "In My Father's House," p. 53.

37. Fitzgerald,"The Contract Buyers League," p. 25.

38. Clark v. Universal Builders, Inc., TP, pp. 2443, 4801-2; Dissertation research notes; Fitzgerald,"The Contract Buyers League," p. 25.

39. Other have observed that early black entrants into changing areas tended to be of equivalent or higher socio-economic status than the whites they were replacing. Duncan and Duncan, The Negro Population of Chicago, pp. 13-15, 221-9; McEntire, Race and Residence, pp. 78-9; Eleanor Wolf and Charles Lebeaux, Change and Renewal in an Urban Community: Five Case Studies of Detroit (New York: Frederick A. Praeger, Publishers, 1969), pp. 52-3; S. Lynn Clark and James H. Kirk, "Characteristics of Minority Group Families Who Have Tried to Move into White Neighborhoods," American Journal of Economics and Sociology 17 (1959), pp. 243-48.

40. Fitzgerald,"The Contract Buyers League," p. 23.

41. Wells v. F & F Investment, TP, pp. 2639, 3085; Deposition of [Peck], taken at the law offices of Jenner and Block, April 14-15, 1970.

42. Fitzgerald,"The Contract Buyers League," p. 40.

43. New home buyers hired lawyers only half as often, in 26 percent of the sample cases. Similar to the sales pitch on mortgage financing, Universal's officers and agents told buyers that a lawyer was not necessary because the house was new and legal advice would be a "waste of money;" Universal could be trusted to "take care of everything;" a lawyer could do no more than the salesman to explain the contract. Persistent buyers were told that a lawyer could only examine the contract papers at Universal's office. Dissertation research notes.

44. The material on lawyer interaction with contract clients relies heavily on Fitzgerald, "The Contract Buyers League," pp. 39-45.

45. Coleman v. Goran, in the Illinois Appellate Court No. 47992, 1960. For an abstract of the opinion see 26 Ill. App. 2d 288, 168 N. E. 2d 56 (1st Dist. 1960), cited by Fitzgerald,"The Contract Buyers League," note 18, chapter 1, p. 470.

46. Fitzgerald,"The Contract Buyers League." pp. 44-5.

47. Alan Boles, "The Contract Buyers League: A Personal Evaluation," Yale Review of Law and Social Action 1 (Spring 1970), p. 87.

48. Fitzgerald,"The Contract Buyers League," pp. 60-138, 206-243, 289-376; McPherson, "In My Father's House."

49. John Ducey, "An Economic Analysis," in The Management of Neighborhood Change (Chicago: Chicago Commission on Human Relations, 1959), pp. 20-4.

50. U. D. Department of Housing and Urban Development, "Required Identification of Ownership Where Seller Is Not the Owner Occupant, Existing Properties; Use of Modified Cost Approach On Existing Properties In Areas Dominated By Speculator Activity," Circular, HPMC-FHA 4035.8 Change 1, March 4, 1971, p. 1.

51. Norris Vitchek as told to Alfred Balk, "Confessions of a Blockbuster," Saturday Evening Post 235 (July 14-July 21, 1962). Norris Vitcheck is a pseudonym for one of the speculators operating on the west side of Chicago during the time period under study. The "ghost writer", who was then a reporter for the Chicago Sun-Times, refused to reveal the identity of his source, but affirmed, in an interview with one researcher, that the facts contained in the article are totally faithful to the speculator's story and business documents. Fitzgerald,"The Contract Buyers League," note 3, chapter 1, pp. 466-7.

52. See John Yinger, "Economic Incentives, Institutions, and Racial Discrimination: The Case of Real Estate Brokers," Discussion Paper No. 78-4, Department of City and Regional Planning (Cambridge: DCRP, Harvard University, 1978); Rose Helper, Racial Policies and Practices of Real Estate Brokers (Minneapolis: University of Minnesota Press, 1969).

53. Helper, Racial Policies and Practices of Real Estate Brokers, p. 255.

54. Ibid., p. 173.

55. Michael Stegman, Housing Investment in the Inner City (Cambridge: MIT Press, 1972), p. 202. While spoken by a Baltimore speculator, this attitude was characteristic of speculators in Chicago.

56. Wells v. F & F Investment, TP, pp. 4981-5053; Wallace, "Residential Concentration of Negroes"in Chicago, p. 136.

57. As shown in Table 2-7, the present value net profit is very sensitive to the discount rate. See note 18 , Chapter 4, infra, for the note on the choice of a discount rate.

58. Stegman, Housing Investment in the Inner City, p. 206.

59. Cashing out through the sale of contract paper was common among only 6 of the 23 contract originators ; it was also most prevalent in the west side market. These sales commonly took place within three years of the contract sale. One of the largest operators died in the early sixties and most of his contract paper sales occurred after his death as part of the estate settlement.

60. With few exceptions, the sale of contract paper to individual investors, investment syndicates and mortgage companies was a pre-1966 occurrence. The timing of paper sales and FHA refinancing reveals an overlap principally in 1966, the advent year of the FHA option. The option of cashing out with FHA refinancing was more profitable, and did not demand a continuing obligation. One speculator noted that two major investment companies, interested in the risk attached to the paper they were buying, made the seller guarantee to buy back any contracts on which the buyer defaulted within one year of the paper sale. Wells v. F & F Investment, TP, p. 6286.

61. In 1966, FHA revised its underwriting guidelines with repsect to neighborhood ratings. Prior to that time FHA mortgages in transitional areas on the west side were not written. Jenner and

Block, "Study on FHA Insured Loans," trial memorandum for Wells v. F & F Investment, June 26, 1975. See Chapters 3 and 6, infra, for further discussion of pre-1966 and post-1966 FHA policy.

62. Section 453, IRS Tax Code (154), Anderson, Tax Factors in Real Estate Operations 139 (2d ed., 1955), cited by Lance Liebman and Elliot M. Surkin, "Real Estate Planning: Land Development and Finance," Problem II, Harvard Law School, September 1978, pp. 50-2, 61-2. To qualify for the installment sale, the first year's income had to equal less than 30 percent of the sales price. This was rarely a binding constraint in the low-downpayment contract sales market.

63. Satter, "Land Contract Sales in Chicago," p. 263.

64. For a discussion of the implications of the mass invasion-transition pattern, see Wallace, "Residential Concentration of Negroes in Chicago," and E. Frederick Schietinger, Racial Succession and Changing Property Values in Chicago (Chicago: Committee on Education, Training and Research in Race Relations of the University of Chicago for the Council Against Discrimination of Greater Chicago, June 1953).

65. This was the number of defendant-sellers at the time the data was collected for the CBL "random sample" (see note 14, Chapter 2, supra).

66. Classification as a contract originator -- one who purchased and sold property on contract to a black buyer -- did not preclude inclusion of a minor number of contract properties acquired through assignment by purchase of contract paper.

67. Rapkin and Grigsby also found that the professional traders in transitional neighborhoods accounted for a large proportion, about 50 percent, of all short-term holdings by absentee owners. Chester Rapkin and William Grigsby, The Demand for Housing in Racially Mixed Areas (Berkeley and Los Angeles: University of California Press, 1960), pp. 112-13.

68. All names of contract sellers and assignees represent pseudonyms.

69. Peck and Master's dominant sales position in the south side market is also revealed in a study conducted by the Chicago Commission on Human Relations on the financing arrangements in a "typical" neighborhood undergoing racial transition between 1955 and 1957. This in depth study of a square census block revealed the following characteristics of housing finance among the 27 owner-occupied structures:

- 4 warranty deed sales, 3 directly to a black buyer and one rental;
- 23 LIC sales:
  - 6 direct LIC transactions between white seller and black buyer;
  - 17 speculative LIC transactions:
    - 9 or 53 percent of the speculative LIC sales by Peck and Master;
    - 3 or 18 percent of the speculative LIC sales by Johns;
    - 5 or 39 percent of the speculative LIC sales by others or unknowns.

Chicago Commission on Human Relations, Selling and Buying Real Estate in a Racially Changing Neighborhood (Chicago: CCHR, 1962).

70. "Complaint," Contract Buyers League v. F & F Investment, No. 69 C15, U. S. District Court, Northern District of Illinois, Eastern Division, Chicago, pp. 24-5.

71. Jenner and Block Law Offices, Memorandum, To: John Stifler, From: Michael Gallagher, Re: Relationships among defendants, 11/10/71 (hereinafter cited as J & B Memo #1).

72. Wells v. F & F Investment, TP, p. 616.

73. Cone mentioned such price considerations during the trial. Wells v. F & F Investment, TP, p. 3904.

74. For an example of such relationships in brokerage and other conveyance fees, see Bruce M. Owen, "Kickbacks, Specialization, Price Fixing, and Efficiency in Real Estate Markets," Stanford Law Review 29 (1977), pp. 931-67.

75. Letter from Boston to his partner in this transaction, dated 1/12/57.

76. Unpublished notice of intent, private circulation, by Friendly Loan Corporation (Boston).

77. The fact that Boston offered higher sale commissions to his scouts for property acquisitions than for sales suggests that sellers considered that end of the transaction to be more critical. Boston correspondence, January 23, 1962. Dissertation research notes.

Notes: Chapter 3

1. The Supreme Court did not outlaw the enforcement of racial restrictive covenants in deeds until 1948. Furthermore, the Code of Ethics of the National Real Estate Board openly discouraged integrated housing and several members of the Chicago Board felt that formal sanctions such as denial of membership, suspension, or expulsion could have been applied to nonconforming realtors who violated the Code. Informal sanctions included spreading "unsavory rumors" about the realtor and harming his business by defaming his character. Rose Helper, Racial Policies and Practices of Real Estate Brokers (Minneapolis: University of Minneapolis Press, 1969), pp. 253-54. For a formal representation of these informal sanctions, see John Yinger, "Economic Incentives, Institutions, and Racial Discrimination: The Case of Real Estate Brokers," Discussion Paper D78-4, Department of City and Regional Planning, Harvard University (Cambridge: DCRP, February 1978).

2. Institutional involvement in the process of racial change would additionally include fostering expectations of change, not only through the withdrawal of funds prior to change, but with direct encouragement to prospective white buyers to look in suburbia. The current policy debate on redlining focuses on the withdrawal issue. See Urban-Suburban Investment Study Group, The Role of Mortgage Lending Practices in Older Urban Neighborhoods: Institutional Lenders, Regulatory Agencies and Their Community Impacts (Chicago: Center for Urban Affairs, Northwestern University, 1975); Illinois Legislative Investigating Commission, Redlining: Discrimination in Residential Mortgage Loans, A Report to the Illinois General Assembly (Chicago: ILIC, May 1975).

3. Chicago Commission on Human Relations, Mortgage Availability for Nonwhites in the Chicago Area: A Report (Chicago, CCHR, April 1963), pp. 5-6.

4. There is some difficulty in actually ascertaining the full extent of the reluctance of banks to lend to black buyers in transitional or all white neighborhoods. McEntire cites some evidence that blacks could not get mortgages in Chicago in "transitional" neighborhoods (pp. 226-27). Winkler attemted to research the practices of Chicago banks in the early 1960s , and was basically unable to obtain any cooperation. The few banks who answered his questionnaire claimed they did not discriminate against blacks, but did mention the problems blacks had in meeting "credit standings" at other lending institutions. They also mentioned a reluctance to lend to blacks in "white or transitional areas". (R. A. Winkler, "Some Aspects of the Negro Housing Market in the Chicago Area: Savings and Loan Financing," in Open Occupancy vs. Forced Housing Under the Fourteenth Amendment: A Symposium on Anti-Discrimination Legislation, Freedom of Choice, and Property Rights in Housing, Alfred Avins, ed. (New York: Bookmailer, 1963), pp. 271-72.) The dubious nature of even this limited evidence of some finance being available for blacks is revealed by the fact that one of Winkler's respondents was [Provident] SLA which claimed that 95 percent of its business was with "non-whites". Yet this institution was one of those making a lot of money available to the speculators in the Lawndale area. It may well be that a good part of the 95 percent went to white speculators in changing neighborhoods. As far as "credit standing" is concerned, many buyers reported that they were denied mortgage consideration without even being asked for credit information.

5. The role of the real estate community has been amply treated elsewhere. See in particular Helper, Racial Policies and Practices; and Yinger, "Economic Incentives, Institutions, and Racial Discrimination." For a discussion of the legal system and the contract buying issue see Jeffrey M. Fitzgerald, "The Contract Buyers League and the Courts: A Case Study of Poverty Litigation," Law Society Review 9 (Winter 1975), pp. 165- 95.

6. There are other economic reasons for the observed lack of lending in black and transitional areas. The objective risk factors

associated with credit-worthy borrowers (occupation, working wives, moonlighting jobs, age of housing, credit references) may systematically discriminate against black borrowers because of discrimination in other sectors, and cause the "objective" risk of a black buyer with the same income as a white person to be higher on average. Also, lenders may imperfectly perceive the costs and risks of lending in certain submarkets due to inadequate knowledge and high search costs. For a general discussion of these issues, see Dwight M. Jaffee, "Credit for Financing Housing Investment: Risk Factors and Capital Markets," Housing in the Seventies, U. S. Department of Housing and Urban Development (Washington, D. C.: GPO, 1976), pp. 491-511; Brimmer & Company, Inc., Risk vs. Discrimination in the Expansion of Urban Mortgage Lending, prepared for the U. S. League of Saving Associations (Chicago: U. S. League of Savings Associations, April 1977).

7. Kain and Quigley, Housing Markets and Racial Discrimination, Table 3-2, p. 63; Brian J. L. Berry, "Short-Term Housing Cycles in a Dualistic Metropolis," The Social Economy of Cities, Harold M. Rose, ed. (Beverly Hills: Sage Publications, Inc., 1975), p. 171.

8. Anti-Negro violence accompanying residential expansion of the ghetto was commonplace for at least ten years following World War II, a period corresponding to housing shortages resulting from war restrictions. Nineteen hundred and fifty-seven is the last year that the Chicago Commission on Human Relations published information on racial tension areas in the city; after that the publications concentrated on the finance problems of Negro buyers, panic peddling and contract buying. Chicago Commission on Human Relations, Reports of Incidents 1949-1952 (Chicago: CCHR, 1952); idem , The Trumbull Park Home Disturbances: A Chronological Report, August 4, 1953 to June 30, 1955 (Chicago: CCHR, 1955); idem , Profiles on Present Racial Tension Areas in Chicago (Chicago: CCHR, 1957). For a map showing the location of personal violence and property damage associated with anti-Negro incidents between 1946-1952, see David Wallace, "Residential Concentration of Negroes in Chicago" (Ph.D. dissertation, Department of Regional Planning, Harvard University, 1953), Figure 55, p. 406.

Based on research of metropolitan Chicago housing trends, Brian Berry also advanced the hypothesis that resistance to transition was lowest when new construction exceeded that needed to meet the demand of new household formation. Berry, "Short-Term Housing Cycles in a Dualistic Metropolis," in The Social Economy of Cities, p. 166.

9. The best known of these studies was completed by Luigi Laurenti, Property Values and Race (Berkeley: University of California Press, 1960). Also see David H. Karlen, "Racial Integration and Property Values in Chicago," Urban Economics Report # 7, University of Chicago, April 1968; Donald Phares, "Racial Change and Housing Values: Transition in an Inner Suburb," Social Science Quarterly 52 (December 1971), pp. 560-73; Joseph P. McKenna and Herbert D. Werner, "The Housing Market in Integrating Areas," Annals of Regional Science 4 (December 1970), pp. 127-33.

10. McEntire, Residence and Race (Berkeley: University of California Press, 1960), p. 226.

11. Ibid., p. 225.

12. Chicago Commission on Human Relations, Mortgage Availability for Non-whites in the Chicago Area, p. 10.

13. McEntire, Residence and Race, p. 225.

14. U. S. Commission on Civil Rights, Housing: Hearings Held in Chicago, Illinois, May 5-6, 1959 (Washington, D. C.: GPO, 1959), p. 756.

15. As quoted by Karen Orren, Corporate Power and Social Change (Baltimore: Johns Hopkins University Press, 1974), p. 127.

16. McEntire, Residence and Race, p. 301. The FHA need not have started its career with this position, but several factors strongly influenced its racial policy. The legislative decision to provide mortgage insurance and to rely upon the existing set of market institutions to initiate loans rather than offer mortgage loans directly reflected an acceptance of prevailing philosophy and pro-

cedures. In general, at the time of the legislative discussion, federal involvement in housing markets was opposed for many reasons by many interests, not the least of which was because its direct involvement could potentially lead away from residential patterns of segregation. As a national program, the FHA was apt to formulate policies which would be acceptable throughout the nation, thereby gaining maximum Congressional support. A laissez-faire attitude toward local implementation of the FHA programs was the quid pro quo for passage. As Weaver noted, the financial institutions through which the FHA operated and its key personnel were recruited from the financial and real estate interests and institutions which led the campaign to spread race covenants and residential segregation. Robert C. Weaver, The Negro Ghetto (New York: Harcourt, Brace and Company, 1948), p. 70. Given the FHA's goals to foster homebuilding and mortgage lending during the depression (with particular emphasis on middle-class homeownership), and their method of program implementation (straight-line as opposed to variable insurance fees, and debentures as opposed to cash reimbursement in case of foreclosure); reliance on the standardization of risk through the standardization of a major factor contributing toward product heterogeneity -- property location -- is not surprising. Orren, Corporate Power and Social Change, p. 135.

17. Since the VA adopted many of the FHA minimum property requirements by reference in their lenders' handbook, it may be assumed that the VA similarly adopted the FHA restrictions on lending in racially changing and black areas. Because VA benefits seem to have been available to more low-income home purchasers and hence to more non-whites than FHA benefits, and because VA financing was a major potential source of mortgage finance for black veterans, the restrictions had a binding effect on serving the program's intended clientele. Jenner & Block Law Offices Memorandum, To: Thomas P. Sullivan, From: Larry Gavin, Re: CBL Veterans Administration Home Loan Guaranty Procedure, April 19, 1971 (hereinafter cited as J & B Memo #3).

18. See Charles Abrams, Forbidden Neighbors (New York: McGraw Hill, 1955), pp. 227-37; U. S. Commission on Civil Rights, 1961 Report: Part IV, Housing (Washington, D. C.: GPO, 1961), pp. 16-80.

19. The complaint, originally brought against real estate speculators, their assignees, and savings and loan associations, was amended to include the Federal Housing Administration as a defendent. "Third Amendment to the Complaint," Contract Buyers League v. F & F Investment, No. 69 C15, Chicago, U. S. District Court, Northern District of Illinois, Eastern Division, Chicago, Count VII, paragraphs 16(e) (f), 19(a) (b), cited by Jenner and Block Law Offices, "The Contract Buyers League Case Against the Federal Housing Administration," Chicago, undated manuscript.

20. Jenner & Block Law Offices Memorandum, To: Thomas P. Sullivan, From: John G. Stifler, Re: Baker v. F & F Investment, FHA Discovery [Interview with former FHA employee, name withheld in confidence], April 16, 1971 (hereinafter cited as J & B Memo #2), p. 5.

21. There was probably no property in the west side contract sale neighborhoods which could have met such requirements. The legal strategy would have to show that FHA insured in other areas in which homes did not meet the minimum property requirements. Letter to Thomas P. Sullivan, from Lawrence M. Gavin, September 14, 1971; Jenner & Block Law Offices Memorandum, To: Thomas P. Sullivan, From: Larry Gavin, Re: FHA Discovery, February 9, 1971 (hereinafter cited as J & B Memo #4), p. 5.

22. J & B Memo #2, p. 2; Baker v. F & F Investment, pretrial deposition of a former FHA employee [name withheld in confidence] February 18, 1975 (hereinafter referred to as pretrial deposition, FHA employee), pp. 61-2.

23. J & B Memo #4.

24. This latter date was limited by the interviewee's knowledge of such practices based on his position in the field insuring office until December 1961; he could not speak from experience about the

rest of the sixties. However, the chief appraiser at the local office, under whom this person worked until that time, remained in the top position until his retirement in 1969. Therefore, without a special directive from Washington, D. C., there is little reason to believe that the automatic rejection policy was altered prior to 1965.

25. At times the chief underwriter for the Chicago field office would make a field trip to examine areas to see if they would be acceptable. After the field trip, he would send a memo around with his determinations of the area and would give the boundaries of the areas in which FHA would not insure. Copies of these memos went to lenders and appraisers and copies were kept at the receiving desk. Between 1955 and at least 1961, the inner-city areas were considered economically unsound. Pretrial deposition, FHA employee, pp. 61-6.

26. "Plantiffs' Pre-Trial Memorandum," Wells v. F & F Investment, No. 69 C15, U. S. District Court, Northern District of Illinois, Eastern Division, Chicago, February-March 1975, p. 14.

27. J & B Memo #2, p. 6. The interviewee, an acting assistant regional administrator of the FHA at the time of the federal official's visit, was responsible for destroying the regional office's redlining maps. In his pretrial deposition, however, he would not explicitly state whether the FHA Chicago office had redlining maps; he did state that the Detroit office had such maps as late as 1968 or 1969.

Orren also noted that no redlining maps were available for her research but that the FHA maps developed after the "economic soundness" policy reversal, which indicated "A" and "B" riot-prone areas, in the opinion of several institutional mortgage officers, represented the mirror image of FHA's prior readiness to extend insurance. Orren, Corporate Power and Social Change, p. 136.

28. See p. 217-21, supra.

29. FHA Manual Sec. 1320, cited in J & B Memo #2, pp. 61-2.

30. See Chapter 2, note 27. The analysis in this section utilizes the 1960-61 sample to represent insured loan activity con-

current with the period of greatest contract sales activity. To the best of our knowledge, this sample represents both inactive and active FHA files, since FHA was approximiately five years behind in pulling the inactive files from the active ones. Jenner and Block Law Offices Memorandum, From: Mary Gavin, Larry Gavin, Al Worley, Re: Procedure for FHA Study 1960-61, August 5, 1975 (hereinafter cited as J & B Memo #5).

31. Evelyn M. Kitagawa and Karl E. Taeuber, eds., Local Community Fact Book Chicago Metropolitan Area 1960 (Chicago: Chicago Community Inventory, University of Chicago, 1963), p. 103.

Additional conclusions from the Jenner and Block FHA study included the following: the racially changing and black areas in which FHA insured in Chicago in 1960 and 1961 had comparable or lower median family incomes than the predominantly all white areas in which FHA insured in the same period; FHA did not insure loans in any census tract where the median family income in 1960 was less than $5,000. Furthermore, they found no substantial difference in the age of the buildings in the racially changing, black areas, or white areas in which FHA insured in Chicago in 1960-61. The FHA insured in areas where a great proportion of the homes were built prior to 1930, and in some instances, insured loans on homes which were built prior to 1920. Based on a limited sample, there appeared to be no substantial differences between the average terms for loans insured in any of the areas. Jenner and Block Law Offices Memorandum, To: Thomas Sullivan, et al., From: Lawrence M. Gavin, Al Worley, Mary Gavin, Re: Study on FHA Insured Loans, Chicago, June 26, 1975, (hereinafter cited as J & B FHA Study), pp. 1-2.

32. Pretrial deposition, FHA employee, p. 102.

33. U. S., Congress, House, Committee on Banking and Currency, Second Mortgages, Land Sale Contracts, and Other Financing Devices Employed in Conventional Mortgage Lending, 86th Congress, January 1960, p. 14.

34. J & B Memo #2, p. 5. In the opinion of the FHA administrator , many of the contract sellers had connections with City Hall and were not willing to budge an inch in negotiations.

35. See U. S. Commission on Civil Rights, 1961 Report: Part IV Housing, pp. 62-74. While the announced policies of both the FHA and VA were in favor of equal housing opportunity, few positive, affirmative actions were taken to insure that the benefits of these government programs reached all home buyers on an equal opportunity basis. "Both agencies will, under limited circumstances, withhold the benefits where discrimination is demonstrated. But they will only do this in States which have antidiscrimination housing laws; and only after the State enforcement authorities have found a violation of State law and the violator has not satisfactorily complied -- a combination of circumstances which has not yet occurred. But where States lack antidiscrimination legislation, members of the private housing industry are free to utilize the credit of the Federal Government in aid of housing discrimination if they choose. Many so choose." Ibid., p. 79.

36. Irving Schweiger and John S. McGee, Chicago Banking: The Structure and Performance of Banks and Related Financial Institutions in Chicago and Other Areas (Chicago: Graduate School of Business, University of Chicago, 1966), pp. 70-6.

37. Ibid., p. 79.

38. Ibid., pp. 74-5.

39. U. S. Federal Housing Administration, Commissioner Letter No. 38, November 8, 1965, reprinted in U. S., Congress, House, Committee on Banking and Currency, Real Estate Settlement Costs, FHA Mortgage Foreclosures, Housing Abandonment and Site Selection Policies: Hearings, 92nd Congress, 2nd Session, 1972, pp. 270-71.

40. It is interesting to note that in the late 1960s when the FHA revised its underwriting criteria (at the time of the implementation of the Urban Investments Program), appraisers for the involved government agencies, instructed to disregard the economic life of the surrounding neighborhood and look only at the individual home, were told to look through "rose colored" glasses. Knowing that the older appraisers could never abandon their previous training, a key adminis-

trator of the program suggested that the FHA hire new people and train them in this new method of appraising. This procedure continued as FHA policy until at least mid-1971. J & B Memo #2, p. 6.

41. Schweiger and McGee, Chicago Banking, p. 70.

42. Ibid., pp. 80-1; J & B Memo #2, p. 4.

43. U. S. Commission on Civil Rights, Housing: Hearings Held in Chicago, p. 750.

44. A set of 565 contract sales has been used for the case study analysis of contract transactions. This data set is larger than the data set used in Chapter 2, for Table 2-1 (419 cases) due to the inclusion of 180 additional installment sales which were the basis for the Wells v. F & F Investment trial proceedings (1975). The two data sets have been merged to increase the number of observations for analysis, since missing data items in the CBL sample of 419 sales invalidated the reliability of the statistical sample. Eliminating the sales which took place prior to 1956 reduced the number of observations to 565. The inclusion of the trial set of installment sales increased the data set proportion of large-scale sellers and properties located in south side community areas.

45. Interview with Mr. Tom Boodell, one of the attorneys for the CBL lawsuits, April 1978.

46. U. S. Commission on Civil Rights, Housing: Hearings Held in Chicago, p. 741.

47. Gross cash investment represents the difference between the acquisition costs of the property (purchase price plus mortgage fees) and the sum of the mortgage loan(s) and contract downpayment.

48. The names of associations and persons (SLA officials, real estate speculators) in this dissertation are disguised, although some information about them is available in court records, newspaper accounts and public reports by the Federal Home Loan Bank Board.

49. Since large-scale sellers are underrepresented in the sample and they were financed more frequently by these four associations, this percent probably underestimates the extent of their participation.

50. H. Robert Bartell, Jr., "An Analysis of Illinois Savings and Loan Associations Which Failed in the Period 1963-1968," in Study of the Savings and Loan Industry, Irwin Friend, ed. (Washington, D. C.: GPO, 1970), p. 414.

51. Ibid., p. 376.

52. Wells v. F & F Investment, TP, pp. 2195, 3137, 3183-187, 3208, 3985.

53. Federal regulations for conventional mortgages prohibited loans in excess of 80 percent of the value of the property. 12 CFR 545.6-1(a), cited by Jenner and Black Law Offices Memorandum, To: D. C. Roston, From: P. Gans, Re: The Regulation of the Federal Home Loan Bank Board, August 12, 1970, p. 5 (hereinafter cited as J & B Memo #6). Illinois regulations before 1964 permitted 100 percent loans of appraised value for single-family homes (after 1965, 90 percent).

The average ratio of mortgage loan-to-appraisal value was, within these regulations, .766 (1963), .742 (1964), .761 (1965); however, on average mortgage loan-to-purchase price exceeded the regulation ratio (Table 3-5).

54. Bartell, "An Analysis of Illinois Savings and Loan Associations," p. 375.

55. Ibid., p. 380.

56. Ibid., p. 375.

57. Ibid., p. 380.

58. Ibid., p. 391.

59. Wells v. F & F Investment, TP, p. 2293.

60. Helper, Racial Policies and Practices of Real Estate Brokers, pp. 180-81. In the course of this study's data collection, inconsistencies between the discount fees stipulated on the mortgage document and discount payments recorded in the speculator's books pointed to such practices.

61. Bartell, "An Analysis of Illinois Savings and Loan Associations," p. 377.

62. Ibid., pp. 415-16.

63. Mortgage application forms used by three different SLAs, confidential source material, Items 1-5.

64. Confidential source material, Items 6, 7.

65. Bartell, "An Analysis of Illinois Savings and Loan Associations," p. 379.

66. Confidential source material, Item 8.

67. Bartell, "An Analysis of Illinois Savings and Loan Associations," p. 380.

68. Ibid., p. 381.

69. Ibid., p. 383.

70. Ibid., pp. 383, 385.

71. Confidential source material, Item 8.

72. In 1963, the FHLBB instituted a new policy of test appraisals to be applied to selected real estate collateral when:

"specific facts or information with respect to mortgage loans on lending, or with respect to operations in general, given evidence that an institution's appraisals may be excessive, that lending may be a marginal nature, that appraisal policies and practices may not conform with generally accepted and established professional standards, or that assets secured by real estate are overvalued." Code of Federal Regulations, 31 FR 8004, June 7, 1966, cited by J & B Memo #6, pp. 3-4.

This and other actions taken on the part of the FHLBB represent a tightening of lending operations and supervision in response to the growing problems of an increasing number of SLAs. See Chapter 6 for a

further discussion of this point.

73. Confidential source material, Item 8.

74. Confidential source material, Item 9.

75. Ibid.

76. Boston was a heavy borrower from two of these three SLAs under discussion. In addition, he had multiple mortgage loans outstanding in a minimum of six other associations.

77. Confidential source material, Item 10.

78. Such conflicts of interest existed in at least two instances; confidential source material, Items 8, 11. In particular, the secretary-treasurer of Dusty SLA was a principal involved in numerous corporate identities which bought and sold contract paper (Hoover, et al., see Figure 2-2 supra).

Conflicts of interest within the savings and loan industry are not new occurrences. The link between savings and loan and real estate businesses has been of "long standing and great intimacy;" lending associations were often organized by real estate interests and domiciled in the same building. Real estate sales affiliations, finance and investment links continue as a significant characteristic of the Chicago FHLB District. The subject of such affiliations elicits conflicting opinions from supervisory examiners. The threat is that the affiliation will affect the association's standards of evaluation of investment quality. Edward S. Herman, "Conflict of Interest in the Savings and Loan Industry," in <u>Study of the Savings and Loan Industry</u>, see in particular pp. 833-47.

79. The regulation in the Code of Federal Regulation (CFR) defines one borrower in such a way that the SLA must know the beneficiary of the trust and the stockholders of the corporation, if they are dealing with a trust or corporation (12 CFR 563, 9-3 amended by 28 FR 1629, February 21, 1963), J & B Memo #6, p. 2. The section limits the amount of monies an association insured by the FSLIC can

lend to one "borrower" to the lesser of 10 percent of withdrawal accounts or the sum of nonwithdrawal accounts. It does not take effect until the amount owed by one borrower exceeds $100,000.

80. Nineteen of these cases occurred in the six-year period between 1963-1968; during this period more SLAs in Illinois were closed due to financial difficulties than in all other states combined. Bartell, "An Analysis of Illinois Savings and Loan Associations," p. 349.

81. An additional two associations were given FSLIC rehabilitation assistance and remained in operation without undergoing mergers at that time. See the 1971 Annual Report of the Federal Home Loan Bank Board for a discussion of types of assistance given by the FSLIC. Federal Home Loan Bank Board Journal 5 (April 1972), pp. 29-36.

82. Ibid., pp. 355-71, 402-7. As Bartell noted, the similar character of the problems in most failed associations suggested that the line between criminal activity and poor management was difficult to draw (p. 408). The line drawn in the Bartell Report reflected a division based on the sufficiency of evidence for legal prosecution.

83. "Plaintiffs' Answers and Objections to the Federal Defendants' Contention Interrogatories," Wells v. F & F Investment, No. 69 C15, U. S. District Court, Northern District of Illinois, Eastern Division, Chicago, May 30, 1974. This number does not include all the contract properties with mortgages financed by these five particular associations because numerous loans, particularly those of Gotham Mutual, were liquidated in salvage operations prior to formal acquisition of assets by the FSLIC. Also, there had been numerous demolitions following abandonments in the late sixties in the west side contract neighborhoods.

84. Bartell, "An Analysis of Illinois Savings and Loan Associations," p. 371.

85. Ibid., p. 382.

86. Confidential source material, Item 8.

Notes: Chapter 4

1. To estimate a "white price" for a particular transaction, that is, to determine whether there is a difference in price paid by whites and blacks for comparable housing, it is necessary to standardize the complex and heterogeneous bundle of residential services so that the effect of the buyer's race can be tested. Empirical estimates must include neighborhood, buyer credit and unit quality characteristics in addition to the standard controls for the physical characteristics of the structure. The methodological complexity of this task usually provides sufficiently fertil basis for criticism of regression results which indicate that blacks pay more than whites for comparable housing. Such results are usually attributed to omitted or poorly specified attributes of neighborhood municipal services or neighborhood amenities.

2. "Discriminatory Housing Markets, Racial Unconscionability, and Section 1988: The Contract Buyers League Case," Yale Law Journal 80 (1971), pp. 524-5.

3. Ibid., p. 528.

4. John F. Kain and John M. Quigley, Housing Markets and Racial Discrimination (New York: Columbia University Press for The National Bureau of Economic Research, 1975), p. 63.

5. Mortgage finance has in the past adapted itself to different price-risk relationships in transitional areas. Given the willingness of lenders to consider the pricing of mortgage finance and the absence of panic selling, discount points act as an important market support. These points, commonly paid by the seller if FHA financing, represent a trade-off between a direct, cash sale and an arbitrage transaction. See Chester Rapkin and William G. Grigsby, The Demand for Housing in Racially Mixed Areas (Los Angeles and Berkeley: University of California Press, 1960), chapter VI.

6. During the trial, one speculator noted that the ability to charge 18 percent interest would have resulted in a different contract selling price. "Transcript of Proceedings," Wells v. F & F Investment, N. 69 C15, U. S. District Court, Northern District of Illinois, Eastern Division, Chicago, pp. 6279-81 (hereinafter cited as Wells v. F & F Investment, TP).

7. Kain and Quigley, Housing Markets and Racial Discrimination, p. 68.

8. Black persons were not the only ones to buy on contract. Speculators also sold to "whites" in changing neighborhoods. The characteristics of these sales, often to mixed couples or persons of Latin descent, were not dissimilar to black contract sales. The gross markups on 7 sales to all-white couples ranged between 61 and 132 percent. Contract terms matched those recorded for black sales, but interestingly, these particular transactions all took place prior to 1955, before the large-scale expansion of the contract market.

9. Wells v. F & F Investment, TP, pp. 893, 1013, 1149, 4295-4302, 6446.

10. Norris Vitchek as told to Alfred Balk, "Confessions of a Blockbuster," Saturday Evening Post 235 (July 14-July 21, 1962).

11. The change in FHA underwriting criteria beginning in November, 1965, did not result in full-scale implementation of that policy in Chicago until 1968. U. S. Congress, Senate, Subcommittee on Housing and Urban Affairs of the Committee on Banking, Housing and Urban Affairs, Oversight on Housing and Urban Development Programs, Chicago, Illinois: Hearings, 93rd Cong., 1st sess., March 30-31, 1973, p. 249. (Beginning in 1966, at least one major west side speculator began to convert his contract sales into FHA mortgages.)

The cases in the 1966-1968 period are predominantly resales of defaulted properties or those sold after a long rental status. These cases naturally drop out of all regression analyses except the contract price model. For the contract price model, the increased sample

variation resulting from the broader time coverage should improve the explanatory power of the model.

12. See notes 13 and 14, Chapter 2, and note 44, Chapter 3, supra.

13. See notes 61, 62, Chapter 1 and note 9, Chapter 2, supra.

14. The subject of repairs on contract properties was a controversial issue in trial litigation. There was a paucity of data to substantiate speculators' claims of repairs; furthermore, there was a conflict between IRS tax requirements and the bookkeeping procedures of certain speculators who claimed to have incurred substantial monies in in "rehabilitation".

To begin with, detailed data on the transactions existed only for the 198 cases brought to trial (representing 7 large-scale and one small-scale speculators). These records indicated that 60, or 30 percent, of the properties had received some repair work between purchase and resale. Only 19 of these cases were sold within six months of purchase and the evidence suggests that the repairs made in the other cases were made prior to renting the unit.

Only two speculators, Peck and Master, kept detailed building ledgers on individual properties in accordance with IRS tax regulations. They had a strategy of buying in advance of racial change, holding the property, with interim rentals, and selling at the point of racial transition. Repair work on their properties was generally performed in connection with rental operations. Repairs just prior to the sample contract sale were made in only six cases; the average repair bill totaled $266. Furthermore, Peck and Master typically included two types of repair clauses in the installment sales contract. One provided that any repairs were to be started within 5 to 15 days of occupancy. Another clause provided for sweat equity as a substitute for a small downpayment. Both clauses often signaled the purchase of a less-than-average quality property. Wells v. F & F Investment, TP, p. 927.

Peck and Master's bookkeeping procedures were the primary subject of the repair controversy. Peck claimed that his rehabilitation work was the key to his mortgage financing and contract profits. He claimed to have maintained two companies for service and repair work on his rental and contract properties, but that his building ledgers would not indicate all repairs made to individual properties. Therefore, the ledgers would underestimate the repairs, and overestimate the profit. He further stated that the IRS permitted him to allocate the repair expenses from these service companies against the taxable income from individual properties. (This resulted in zero profits, for tax purposes, for numerous properties, year after year.) Wells v. F & F Investment, TP, pp. 760-940.

However, the IRS tax regulations in effect in 1960 strongly suggest that Peck's claim of repairs not shown on the building ledgers did not conform to tax procedures and that he would have lost the tax savings from making such repairs.

"In computing the gain or loss from the purchase and sale of a number of properties, the gain or loss must be computed separately as to each such purchase and sale. [Peck] met this requirement by keeping individual building ledgers with identification numbers. His gain on a particular purchase and sale must be computed as follows: (Contract sale price) - (purchase price and adjustments chargeable to the capital account) = gain. Repairs other than those for maintenance must be charged to the capital account and thereby reflected in the property's tax base. Unless [Peck] charged the cost of repairs to the capital account of the particular property repaired, he lost any tax savings he might have had by reason of making such repairs. The cost of repairs (other than for maintenance) can only be reflected in the capital account of the particular property repaired; and further, the cost of repairs cannot be taken as an expense deduction. As soon as [Peck] shows a profit with respect to a particular property, he admits that he has recouped his capital investment and tacitly admits that all repairs are reflected on the building ledger."

Memorandum from the office of Boodell, Sears, Sugrue, Giambalvo & Crowley, To: John Tucker, From: Lawrence M. Gavin, Re: [Peck's] Claimed Repairs, December 18, 1975.

15. Forty-eight percent of the sample transactions were completed within three months. The speculator may have received rental income from these properties, but such income was most likely on those

properties held for a longer time period. Eighteen percent of the sample properties were held between 3 and 12 months prior to sale; 13 percent, two years. Nineteen percent of the sample transactions had been sold at least once prior to the sample transaction.

16. Calculation of the present value of the expected net profit (PVNETPR) did not assume a prepayment factor, although this is a common feature of mortgage loans, precisely because installment contracts inhibited mobility and sellers did not anticipate conversion to mortgage finance apart from the possibility of a seller purchase money mortgage after 50 percent of the principal had been paid.

17. Data was insufficient to distinguish the sales commission practice of individual speculators for individual transactions; instead, it was estimated for all sales and based on the standard rate set by the Chicago Real Estate Board. Between 1955 and 1965, this rate was 5 percent for properties of less than $25,000 with a minimum charge of $100; after 1965 (and for our purposes until 1968), this rate was 6 percent on the first $50,000 with a minimum charge of $300.

The sales commission estimate could be an overestimate of the actual cost incurred because, first, not all sellers secured buyers through real estate agents. Second, several sellers were also real estate brokers and the commission could have been paid to their own offices, thereby increasing the real profit from the transaction for these sellers. Third, some sellers, noteably Peck and Master, did not pay out a full sales commission at the time of the closing; they paid the commission in small equal monthly payments, typically $25 or $35, provided the contract buyer did not default on the contract. If a default occurred, these payments stopped.

18. Any discount rated used would have to be equal to or greater than 10 or 12 percent, since that was the prevailling cost of funds sellers paid for privately secured operating funds.

The primary justification for using a 15 percent discount rate comes from the prevailing belief among real estate agents that contract

sales would increase the selling price of a property 10 - 20 percent to compensate the seller for the deferred payback. Wells v. F & F Investment, TP, pp. 5121, 7896. Also see, Michael Stegman, Housing Investment in the Inner City (Cambridge: MIT Press, 1972), p. 206.

19. See John Mixon, "Installment Land Contracts: A Study of Low Income Transactions, With Proposals for Reforms and a New Program to Provide Home Ownership in the Inner City," Houston Law Review 7 (May 1970), pp. 530-35 for a full discussion of the cost differences.

20. U. S. Department of Housing and Urban Development, 1967 Statistical Yearbook (Washington, D. C.: GPO, 1968), FHA Table 33, p. 116.

21. This is the equation for the west side market; for the south side, the variable CANDG has been substituted for the LS variable because there is insufficient variation between small-scale and large-scale sellers in the south side market. CANDG distinguishes between the two long-time large-scale speculators, Peck and Master, and the additional large-scale speculator and two small sellers.

22. The set of substandard variables behaved in an opposite manner in the OLS regression model of installment contract price presented in Appendix Tables 2-4. For both submarkets the coefficients of substandard housing variables indicate that prices were higher in neighborhoods with fewer than 10 percent and more than 25 percent substandard units. As a proxy for neighborhood risk, this finding is inconsistent with its sign in the credit arbitrage model. Why should it have a negative effect in the credit model and a positive effect here? One reason may be that the neighborhood risk effects are capitalized into higher prices independent of borrower risk characteristics.

23. Wells v. F & F Investment, TP, p. 494.

24. The marginal price effect of contract downpayment was also small in the regression model on installment contract price (Appendix Table 4). Two characteristics of economic behavior in the contract

market help explain this finding. First, contract prices were set prior to certain knowledge of the cash downpayment, and speculators rarely made credit checks on the buyer which would alter their perception of the risk in the transaction. Second, there was little price negotiation, particularly on the south side.

25. The marginal effect of buying in transitional neighborhoods on the full installment contract price varied over time. The results of the regression model of contract price, presented in Appendix Table 4, indicate that price differentiation in the west side market, among neighborhoods classified by stage of racial transition, was more pronounced than in the south side market. In particular, buyers in early transition neighborhoods in period 3 on the west side paid over $1,109 more for this type of neighborhood than for an equivalent housing bundle in an intermediate transition neighborhood. The proportion of properties sold in these early transition neighborhoods in this period had declined from the earlier periods. The south side market exhibited some price differentiation across neighborhood stage types, but the differentials between time periods were not strong. Furthermore, the discount in neighborhoods of late transition was considerably smaller than in the west side market, $193 versus $2,015.

26. This difference in price behavior between submarkets is further reflected in the relative importance of the CTY60 variable, which is a proxy for neighborhood socio-economic status in the contract price regression model (Appendix Table 4). An increase of $100 in the median income of a south side neighborhood would increase contract price $129, compared to an insignificant $21 in the west side market. The socio-economic differentiation between submarkets is also reflected in the comment of a black federal official who had considerable contact with contract buyers. He noted that "[t]he aspiring middle-class black does not remain on the west side for more than ten years after he becomes an adult. He tries to get to the south side." Jeffrey M. Fitzgerald,"The Contract Buyers League: A Case Study of Interaction Between a Social Movement and the Legal System"(Ph.D. dis-

sertation, Northwestern University, 1972), p. 183. Otis D. Duncan and Beverly Duncan's analysis of the socio-economic characteristics of the population in Chicago's "invasion" tract between 1940 and 1950 further confirms this differentiation between west and south side submarkets. The Negro Population of Chicago: A Study of Residential Succession (Chicago: University of Chicago Press, 1957), p. 229.

27. See note 20, Chapter 4, supra.

28. The sample correlations between NEGEQ and MTGLVR for the west side and south side markets respectively are -.69 and -.59 .

29. See Rao and Miller, Applied Econometrics (Belmont, Calif.: Wadsworth Publishing Co., Inc., 1971), pp. 46-52.

30. Brian J. L. Berry, "Short-Term Housing Cycles in a Dualistic Metropolis," in The Social Economy of Cities, Harold M. Rose, ed. (Beverly Hills: Sage Publications, Inc., 1975), pp. 165-82.

31. John Yinger, "Racial Transition and Public Policy," Policy Note 78-1, Department of City and Regional Planning, Harvard University (Cambridge: DCRP, March 1978), p. 9.

32. Private individuals acting alone or in small groups continue to make black families moving into a white area feel unwelcome. See Robert Schafer, "Discrimination in Housing Prices and Mortgage Lending," Working Paper 59, Joint Center for Urban Studies of the Massachusetts Institute of Technology and Harvard University (Cambridge: JCUS, June 1979), p. 6.

33. Wells v. F & F Investment, TP, pp. 893, 1013, 4295- 302, 6446.

34. Deposition of [Peck], taken at the law offices of Jenner and Block, April 14-15, 1970, p. 146.

Notes: Chapter 5

1. In the opinion of one researcher, conversion to mortgage finance appeared to be a "matter of the seller's episodic behavior." It was precipitated by a number of factors; a sudden source of financing (FHA), a desire to move out of the neighborhood and discontinue managing property, or a sale or transfer of contracts. Although buyers eligible to convert were at times more likely to actually convert their contracts compared to those not eligible, this researcher found that over half of those entitled to convert were still on contract (Colvin, p. 28). He concluded that buyer ignorance or reticence was not necessarily responsible for this fact, but that most conversion requests were met by uncooperative responses, delay, refusal, demands for more money. Very few entitled buyers got offers of mortgages or even notices of entitlement. Sellers were reluctant to convert for four reasons: inability to produce clear title, high mortgage commitments of their own on the property, inability to procure conventional financing for the buyer and preferences for the superior remedies of the contract seller. The increased frequency of conversions after 1966 resulted from FHA mortgage availability, CBL litigation pressure and business termination. Greg Colvin, "The Provision for Mortgage Conversion and Title Conveyance in Installment Contracts For The Sale of Residential Property to Blacks in Chicago," unpublished paper, Contract Buyers League files, Chicago, April 10, 1970.

2. Edmundson Village Under Seige (Baltimore: Activists, 1969), p. 5.

3. Ill. Rev. Stat. ch. 95, Sections 17-23 and ch. 77, Sections 18-27 (1967), cited by "Discriminatory Housing Markets, Racial Unconscionability and Section 1988: The Contract Buyers League Case," Yale Law Journal 80 (1971), footnote 11, p. 520.

4. George M. vonFurstenberg, Technical Studies of Mortgage Default Risk: An Analysis of the Experience with FHA and VA Home Loans During the Decade 1957-66 (Ithaca: Center for Urban Development Re-

search, 1971); John Herzog and James Early, Home Mortgage Delinquency and Foreclosure (New York: Columbia University Press for National Bureau of Economic Research,1970).

5. The realized value of the collateral adjusts the return from the sale of the foreclosed property for the dollar costs associated with foreclosing on the loan.

6. Dwight M. Jaffee, "Credit for Financing Housing Investment--Risk Factors and Capital Markets," in Housing in the Seventies, Volume 1, U. S. Department of Housing and Urban Development (Washington, D. C.: GPO, 1976), p. 499.

7. See Donald R. Lessard and Franco Modigliani, "Inflation and the Housing Market: Problems and Potential Solutions," in New Mortgage Designs For Stable Housing In an Inflationary Environment, F. Modigliani and D. Lessard, eds., Conference Series No. 14, Federal Reserve Bank of Boston (Boston: FRB Boston, 1975), pp. 13-45.

8. John Mixon, "Installment Land Contracts: A Study of Low Income Transactions, With Proposals for Reforms and a New Program to Provide Home Ownership in the Inner City," Houston Law Review 7 (May 1970), pp. 535-54.

9. Ill. Rev. Stat. ch. 77, Sections 18(e) (1967), cited by "Discriminatory Housing Markets," footnote 11, p. 520.

10. Colvin, "The Provision For Mortgage Conversion," p. 2.

11. See Touche Ross & Co., "The Costs of Mortgage Loan Foreclosure: Case Studies of Six Savings and Loan Associations," prepared for the Federal Home Loan Bank Board (Washington, D. C.: FHLBB, April 1975) for an example of the long delay and high cost of mortgage foreclosure in Illinois.

12. Colvin, "The Provision For Mortgage Conversion," p. 3.

13. Ill. Rev. Stat. ch. 57, Sections 1-22 (1967), cited by "Discriminatory Housing Markets," footnote 11, p. 520.

14. Robert Kratovil, "Forfeiture of Installment Contracts in Illinois," Illinois Bar Journal 53 (1964), pp. 188, 197.

15. Ill. Rev. Stat. ch. 57, Section 13 (1967), cited by "Discriminatory Housing Markets," footnote 11, p. 520.

16. Jeffrey M. Fitzgerald, "The Contract Buyers League and the Courts: A Case Study of Poverty Litigation," Law Society Review 9 (Winter 1975), pp. 174-5, see for a discussion of the court procedures in suits for "possession only."

17. Colvin, "The Provision For Mortgage Conversion," p. 38. This author notes that the mortgage in the sixteenth century had the same fault but it was cured by the doctrine of the mortgagor's equity interest, which included the equitable right to redeem and the right to the proceeds of the foreclosure sale over the amount of the debt.

18. Mixon, "Installment Land Contracts," pp. 544-48.

19. Ibid., pp. 544-45.

20. vonFurstenberg, "Default Risk on FHA-Insured Home Mortgages As A Function of the Terms of Financing: A Quantative Analysis," in Technical Studies, p. 13.

21. Gamaliel Foundation, "Progress and Prospects," unpublished paper, Chicago, revised July 1969, p. 10. (Status report of the community organization project, originally known as the Presentation Church Community Organization Project, which initiated the events leading to the organization of the Contract Buyers League.)

22. Contract Buyers League, "The History of The Contract Buyers League," Chicago, unpublished, undated, p. 3. Evidence reviewed by this writer for 148 cases showed that 42 percent of the buyers had invested more than $3,000 for home repairs. Many had large expenses for repairs of heating equipment, roofs, plumbing, and other types of capital repairs.

23. The word potential should be stressed for it is by no means clear that contract buyers took advantage of this tax benefit. Con-

tract sellers presumably did not send end-of-the-year statements of accounts detailing the payment allocation between interest and principal. Furthermore, contract payment books may not have been kept by the buyer or only updated sporadically when sent in with the monthly payment.

24. Michael Stegman, Housing Investment in the Inner City (Cambridge: MIT Press, 1972), p. 208.

25. See page 88 , Chapter 2, supra.

26. Private correspondence between Boston and an associate, August 8, 1957.

27. Joseph Noviki, "Real Estate Appraisal in the Ghetto," The Real Estate Appraiser 35 (September-October 1969), pp. 6-7.

28. There were numerous defaults on mortgages held by west side speculators, in particular those of the largest two operators. "Transcript of Proceedings," Wells v. F & F Investment, N. 69 C15, U. S. District Court, Northern District of Illinois, Eastern Division, Chicago, p. 3258 (hereinafter cited as Wells v. F & F Investment, TP); H. Robert Bartell, Jr., "An Analysis of Illinois Savings and Loan Associations Which Failed in the Period 1963-1968," in Study of the Savings and Loan Industry, Irwin Friend, ed. (Washington, D. C.: GPO, 1970), pp. 383-402.

29. Contract buyers who were able to make partial payments were more likely to benefit from forbearance, since the seller's decision to foreclose depended upon his own mortgage commitments and business cash flow needs as well as local market demand for housing.

30. deVise, "Housing Construction In The Suburbs And Housing Demand And Prices In The Inner City," Working Paper II.23, Chicago Regional Hospital Study (Chicago: CRHS, April 1976, revised November 1976), in U. S. Congress, Senate, Committee on Banking, Housing and Urban Affairs, Home Mortgage Disclosure and Equal Credit Opportunity: Hearings, 94th Cong., 2nd Sess., November 23, 1976, p. 226.

31. Herzog and Early, Home Mortgage Delinquency and Foreclosure,

Table 2, p. 10.

32. Value for FHA mortgages represents the appraisal value. This includes closing costs other than the broker's commission; these closing costs averaged about two percent of the purchase price in 1960. U. S. Department of Housing and Urban Development, 1967 Statistical Yearbook (Washington, D. C.: GPO, 1968), FHA Table 33.

33. Jeffrey M. Fitzgerald, "The Contract Buyers League: A Case Study of Interaction Between a Social Movement and the Legal System" (Ph.D. dissertation, Northeastern University, 1972), pp. 26-31.

34. Ibid., p. 29. This type of trade-off is the underlying hypothesis of Krohn and Fleming's paper on the dual economy and its relationship to the urban housing market. Roger G. Krohn and E. Berkeley Fleming, "The Other Economy and the Urban Housing Problem: A Study of Older Rental Neighborhoods in Montreal," Working Paper No. 11, Joint Center for Urban Studies of the Massachusetts Institute of Technology and Harvard University (Cambridge: JUCS, 1971-1972).

35. Fitzgerald, "The Contract Buyers League," pp. 36-7.

36. Ibid., p. 37. In fact, this was a major stumbling block for the white Jesuits and college students organizing contract buyers into an activist group.

"There was a stigma attached to contract buying, a certain implication of helplessness and ignorance. Public meetings were organized in the basement of Presentation Church, with twenty to twenty-five people in attendance. But they were all silent. Few people wanted to expose their scars to a tall blond white man with piercing blue eyes, surrounded by white helpers..."

The contract issue smoldered and the number of involved west side families remained small until the organizers were able to enlist the active leadership of a black buyer who told her story. James Allen McPherson, "In My Father's House There Are Many Mansions -- And I'm Going to Get Me Some of Them Too," Atlantic Monthly 229 (April 1972), pp. 56, 58. Also see, Alan Boles, "The Contract Buyers League: A Personal Evaluation," Yale Review of Law and Social Action 1 (Spring

1970), pp. 85-7; Gregory L. Colvin, "The Contract Buyers League: The Legal Listening Process," Yale Review of Law and Social Action 1 (Spring 1970), pp. 88-91.

37. Fitzgerald,"The Contract Buyers League," pp. 33, 37.

38. These dates reflect the data collection periods for the two samples of data, 1973 for the "random" sample and 1975 for the plaintiff sample. See note 44, Chapter 3, supra.

39. Occasionally a seller would modify the terms of the agreement if the buyer was having payment difficulty. One seller, Cone, did reduce the interest rate on some contracts from 7 to 5 percent. Wells v. F & F Investment, TP, p. 4064.

40. vonFurstenberg, "Default Risk on FHA-Insured Home Mortgages," in Technical Studies, p. 15.

41. Information on delinquency charges came from individual contract ledgers kept by Peck and Master. Few other speculators were as consistent in their management of contract delinquency. In general, delinquency charges appear to be more characteristic of the south side market. Jenner & Block Memorandum, To: Peter Flynn, From: Mary Gavin, December 23, 1975, Re: [Church's] Default Procedures; Dissertation research notes on individual cases.

42. Dissertation research notes on individual cases.

43. Fitzgerald, "The Contract Buyers League," p. 35.

44. Noviki, "Real Estate Appraisal in the Ghetto," pp. 6-7.

45. See Fitzgerald, "The Contract Buyers League," pp. 194-410 for a detailed discussion of buyers' perspectives toward paying off the contract which prevailed during the heat of the CBL controversy.

46. Ibid., p. 196. The acceleration of repossessions after 1968 further supports this observation.

Notes: Chapter 6

1. U. S. Congress, Senate, Subcommittee on Banking, Housing and Urban Affairs, Oversight on Housing and Urban Development Programs, Chicago, Illinois: Hearings, 93rd Cong., 1st sess., March 30 and 31, 1973, pp. 26-41, 203-229, 311-322; F. Lawlor, FHA Report, Chicago City Council, August 1974; Judith D. Feins, "Urban Housing Disinvestment and Neighborhood Decline: A Study of Public Policy Outcomes" (Ph.D. dissertation, University of Chicago, 1977); L. Chatterjee, D. Harvey and L. Klugman, FHA Policies and the Baltimore City Housing Market, Center for Metropolitan Planning and Research, Johns Hopkins University (Baltimore: CMPR, April 1974).

2. U. S. Congress, Senate, Subcommittee of the Committee on Banking and Currency, Financial Institutions Supervisory Act of 1966: Hearings on S. 3158, 89th Cong., 2nd sess., April 4, 5, 7, 12; May 17, 18, 19; 1966, p. 60.

3. Federal Home Loan Bank Board, 35th Annual Report, 1967 (Washington, D. C.: FHLBB, 1968), p. 85.

4. In the 6-year period from 1963-1968, more savings and loan associations in Illinois were closed because of financial difficulties than in all other States combined. In 1969, the losses to the FSLIC from these closings were estimated at $92 million, which represented 75 percent of the total estimated losses suffered by the FSLIC during that period. This figure was subsequently revised, but not published. (Prior to 1963, losses to the FSLIC from all insurance cases since the corporation's beginning totalled only $8.5 million.) H. Robert Bartell, Jr., "An Analysis of Illinois Savings and Loan Associations Which Failed in the Period 1963-1968," in Study of the Savings and Loan Industry, Irwin Friend, ed. (Washington, D. C.: GPO, 1970), p. 353.

Not all of these associations were involved in speculative finance of contract sales. Unfortunately, Gotham Mutual's losses, the largest lender in the contract market, were not made public.

5. Federal Home Loan Bank Board Office of Examinations and Supervision, "Problems Resulting From Tenement and Other Inner City Lending to Real Estate Investors," Memo # R-20, January 16, 1969, distributed to all FHLBB examiners and state supervisory authorities, in U. S. Congress, Senate, Committee on Banking, Housing and Urban Affairs, Home Mortgage Disclosure Act of 1975: Hearings on S. 1281, 94th Cong., 1st sess., May 5, 6, 7 and 8, 1975, Part 1, pp. 687-92. Thomas Bomar, Chairman of the FHLBB, remarked that "[e]xperience has demonstrated that neighborhoods can be effectively altered or destroyed by unscrupulous real estate speculators," U. S. Congress, Home Mortgage Disclosure Act, p. 598.

6. These measures were part of an overall program of "preventive supervision," Federal Home Loan Bank Board Journal Special Issue: 1973 Annual Report (April 1974), p. 35.

7. FHLBB, "Problems Resulting From Tenement," in U. S. Congress, Home Mortgage Disclosure Act, p. 690.

8. Ibid.

9. Federal Home Loan Bank Board, 38th Annual Report, 1970 (Washington, D. C.: FHLBB, 1971), p. 35.

10. General Accounting Office, "Report on Audit of Federal Savings and Loan Insurance Corporation, Supervised by Federal Home Loan Bank Board, Year Ended June 30, 1963," in U. S. Congress, Financial Institutions Supervisory Act of 1966, p. 82.

11. Hugh O. Nourse and Donald Phares, "The Impact of FHA Insurance Practices on Urban Housing Markets in Transition -- The St. Louis Case," Urban Law Annual 9 (1975), p. 111.

12. Bartell, "An Analysis of Illinois Savings and Loan Associations," p. 413.

13. Department of Housing and Urban Development, FHA, Commissioner Letter No. 63, FW-474, July 31, 1967, reprinted in U. S. Commission

on Civil Rights, Home Ownership For Lower Income Families: A Report on the Racial and Ethnic Impact of the Section 235 Program (Washington, D. C.: GPO, 1971), p. 112-

14. Ibid. Section 203(1) was aimed at neighborhoods where rioting or other civil disorders had occurred or were threatening. Cited by Peter M. Greenston, C. Duncan MacRae and Carla I. Pedone, "The Effects of FHA Activity in Older, Urban, Declining Areas: A Review of Existing, Related Analysis," Research Report 220-1, The Urban Institute (Washington, D. C.: Urban Institute, February 1975), p. 7.

15. Greenston, MacRae and Pedone, "The Effects of FHA Activity in Older, Urban, Declining Areas," p. 9.

16. Oversight on Housing, Chicago, p. 249. Statement by Ronald C. Nelson, Chairman of FHA Single Family Subcommittee, Chicago Mortgage Bankers Association.

17. Jenner & Block Law Offices Memorandum, To: Thomas P. Sullivan, From: John G. Stifler, Re: Baker v. F & F Investment, FHA Discovery [Interview with former FHA employee, name withheld in confidence] (hereinafter cited as J & B Memo #2).

18. Brian D. Boyer, Cities Destroyed for Cash: The FHA Scandal at HUD (Chicago: Follett Publishing, 1973), p. 182, 188.

19. This comment on the volume of potential prosecutions arising from FHA program abuses was made by Mr. Anton Valukas, Deputy Chief, Special Investigations Division, U. S. Attorney's Office (Northern District of Illinois) at the time of the 1971 investigations. Cited by Peter Katsaros, Memorandum to the [Illinois] Governor's Commission on Mortgage Practices, Appendix II (undated), in Home Ownership in Illinois, The Elusive Dream, Report of the Governor's Commission on Mortgage Practices to Governor Dan Walker of Illinois, in U. S. Congress, Home Mortgage Disclosure Act, p. 146.

20. U. S. Congress, Oversight on Housing, Chicago, p. 136.

21. "Transcript of Proceedings," Wells v. F & F Investment, N. 69 C15, U. S. District Court, Northern District of Illinois, Eastern Division, Chicago, p. 5963 (hereinafter cited as Wells v. F & F Investment, TP); deposition of John [Cone], taken at the offices of Jenner & Block, February 17, 1970, p. 205.

22. The FHA activities of at least one west side speculator culminated in a series of fraud convictions, Wells v. F & F Investment, TP, p. 5823-4.

23. Calvin P. Bradford, Leonard S. Rubinowitz, and James McGowan, "Sample of HUD-FHA Single-Family Firm Commitments in the Chicago Metropolitan Area," in The Role of Mortgage Lending Practices in Older Urban Neighborhoods: Institutional Lenders, Regulatory Agencies and Their Community Impacts (Evanston: Center for Urban Affairs, Northwestern University, 1975), pp. 383-96; Lawlor, FHA Report; Nourse and Phares, "The Impact of FHA Practices on Urban Housing Markets in Transition;" David J. Fullerton and C. Duncan MacRae, "FHA, Racial Discrimination and Urban Mortgages," Journal of the American Real Estate and Urban Economics Association 6 (Winter 1978), pp. 451-70; Chatterjee, Harvey and Klugman, FHA Policies and the Baltimore City Housing Market; Boyer, Cities Destroyed for Cash.

24. Greenston, MacRae and Pedone, "The Effects of FHA Activity in Older, Urban, Declining Areas," pp. 38-46.

25. Chatterjee, Harvey and Klugman, FHA Policies and the Baltimore City Housing Market, pp. 3, 7, cited by Greenston, MacRae and Pedone, "The Effects of FHA Activity in Older, Urban, Declining Areas," p. 42. Also for Chicago, see Feins,"Urban Housing Disinvestment and Neighborhood Decline,"pp. 239-72 for the results of a five-neighborhood study on patterns of mortgage lending between 1950-1970.

26. U. S. Congress, Oversight on Housing, Chicago, statement of Father Richard Dodaro, Chairman, Our Lady of The Angeles Parish, p. 34.

27. Ibid., p. 33.

28. Ibid., p. 36.

29. Ibid., statement of Father Francis X. Lawlor, Alderman of the Fifteenth Ward, City of Chicago, p. 312.

30. Ibid.

31. Ibid., pp. 312-3.

32. Ibid., p. 313.

33. Ibid., pp. 36, 205.

34. Ibid., statement of the West Side Real Estate Board, Chicago, Ill., Mr. Marcelino Diaz, p. 324.

35. Ibid., James W. Compton, Executive Director, Chicago Urban League, pp. 178-80; statement of Dempsey J. Travis, United Mortgage Bankers of America, pp. 263-75; statement of Frank J. Williams, President, Dearborn Real Estate Board, pp. 277-78.

36. Lawlor, FHA Report; Illinois Legislative Investigating Commission, Mortgage Lenders' Kickbacks To Real Estate Brokers, A Report to the Illinois General Assembly (Chicago: ILIC, October 1976); idem, Redlining: Discrimination in Residential Mortgage Loans, A Report to the Illinois General Assembly (Chicago: ILIC, May 1975), pp. 52-64; U. S. Congress, Oversight on Housing, Chicago, pp. 33-4; Anton Valukus, former Deputy Chief, U. S. Attorney's Office, Chicago, see note 49,Chapter 6, infra.

37. Boyer, Cities Destroyed for Cash, p. 181.

38. Illinois Legislative Investigating Commission, Mortgage Lenders' Kickbacks, p. vi.

39. There were a number of ways in which real estate agents and mortgage bankers, working in a close relationship, violated the industry's "arm's length" standard: (1) payment of finder's fees, (2) payment for processing services, (3) through conflicts of interest with mortgage company affiliates, (4) discount averaging of loans, and (5) net pricing. Ibid., pp. 9-11.

40. U. S. Department of Housing and Urban Development, HPMC-FHA 4035.8, December 30, 1970, reprinted in U. S. Commission on Civil Rights, Home Ownership for Lower Income Families, pp. 115-8.

41. U. S. Department of Housing and Urban Development, HPMC-FHA 4035.6, December 23, 1970; Jenner and Block, trial preparation materials for Wells v. F & F Investment.

42. U. S. Department of Housing and Urban Development, HPMC-FHA 4035.9, December 31, 1970, reprinted in U. S. Commission on Civil Rights, Home Ownership for Lower Income Families, pp. 120-1.

43. Ibid., p. 118.

44. They also earn money through other "front-end" fees (interest on "warehouse loans" and the commissions and discounts from the sale or placement of hazard, title and life insurance. See "The Role of the Mortgage Banker in the FHA-Insured Single-Family Home Loan Process," in The Role of Mortgage Lending Practices in Older Urban Neighborhoods, pp. 121-62.

45. Edwin T. Hood and James A. Kushner, "Real Estate Finance: The Discount Point System and its Effect on Federally Insured Home Loans," University of Missouri in Kansas City Law Review 40 (Fall 1971), p. 5, cited by "The Role of the Mortgage Banker in the FHA-Insured Single-Family Home Loan Process," p. 152.

46. Karen Orren, Corporate Power and Social Change (Baltimore: Johns Hopkins University Press, 1974).

47. Feins, "Urban Housing Disinvestment and Neighborhood Decline," p. 229.

48. Ibid., p. 231.

49. Anton Valukas, while former Deputy Chief, Special Investigative Division of the U. S. Attorney's Office for the Northern District of Illinois, conducted an eighteen-month investigation of employees involved in the appraisal of new and existing homes insured under FHA programs and located in the Chicago SMSA. In an interview

with Peter Katsaros for the Governor's Commission on Mortgage Practices, he stated his belief that bribery and inflated appraisals in FHA transactions were most often tied to "net listing" agreements negotiated between a prospective FHA seller and a real estate broker. Under such agreements, the seller sets his sale price and anything above that price accrues to the broker.

"Valukas found that real estate brokers had bribed FHA inspectors to get inflated appraisals, thus greatly increasing the profitability of the 'net-listing' agreements."

He also believed that the speculation and panic peddling accompanied the negotiation of net-listing agreements. Katsaros memorandum, in Home Ownership in Illinois, in U. S. Congress, Home Mortgage Disclosure Act, p. 147.

In an interview with this writer in April, 1977, Valukas, then in a private law practice, noted that there was a cycle to speculative real estate operations in transitional areas which involved all the major mortgage banking houses in Chicago. Homes were purchased from departing whites and the broker received a flat fee regardless of the sale price. With a $500 bribe, the speculative buyer secured an inflated appraisal. After boosting assets and other borrower credit information, he arranged an FHA mortgage for a minority buyer. Since the houses were often in poor condition and the buyer was a poor credit risk, the default which frequently followed provided the biggest source of profit. After receiving the insured mortgage proceeds, the lender set about "rehabing" the property. The building was gutted and the contents sold; with a contract to rehab the unit, he might even sell back some of the "gutted materials". Afer this rehab was complete, the FHA sale process was repeated. About 75 indictments were issued from the U. S. Attorney's office relating to these practices.

50. The U. S. Attorney's Office for the Northern District of Illinois secured the convictions of a dozen FHA inspectors for bribery. FBI reports substantiated "scores and scores of complaints about false, inflated appraisals," which could not be prosecuted because there was insufficient evidence to convict an FHA official or

fee appraiser for bribery as well as the filing of false applications and the U. S. Attorney's Office had decided to prosecute on both counts or not at all. The rationale was that only a bribery conviction would result in a prison sentence and since the Office was not able to handle such a deluge of potential prosecutions, it would concentrate its efforts on the biggest cases. Katsaros Memorandum, Home Ownership In Illinois, in U. S. Congress, Home Mortgage Disclosure Act, p. 146.

51. See U. S. Congress, Senate, Committee on Banking and Currency, Subcommittee on Housing, Real Estate Settlement Costs, FHA Mortgage Foreclosures, Housing Abandonment, and Site Selection Policies: Hearings, 92nd Cong., 2nd sess., 1972; U. S. Congress, House, Committee on Government Operations, Review of FHA (Part II): Hearings, 93rd Cong., 2nd sess., March 26, 1974; U. S. Congress, House, Committee on Government Operations, Defaults on FHA-Insured Mortgages: Hearings, 92nd Cong., 2nd sess., February 24, 1972; U. S. Congress, House, Committee on Government Operations, Defaults on FHA-Insured Mortgages, Detroit, Michigan, House Report No. 92-1152, 92nd Cong., 2nd sess., 1972; U. S. Congress, House, Committee on Banking and Currency, Investigation and Hearing of Abuses In Federal Low- and Moderate-Income Housing Programs, Staff Report and Recommendations, 1970; Boyer, Cities Destroyed For Cash.

52. The servicing procedures of FHA-insured mortgage servicers and use of the strict foreclosure process effectively reduced the potential forbearance and default advantages of mortgage finance versus contract financing. See George Lefcoe, Causes of Defaults and Foreclosures (Los Angeles: University of Southern California Law Center, December 1974), and Brown v. Lynn, N. 73 C 334, U. S. District Court for the Northern District of Illinois, Eastern Division. This suit is a class action case against HUD, alleging lack of enforcement of forbearance procedures and procedural protection of borrowers' rights in conflicts with lenders or servicers. Cited by Feins, "Urban Housing Disinvestment and Neighborhood Decline," pp. 280-81.

53. The effects of FHA program administration outside of the inner-city transitional areas continued to display a segregated pattern, since FHA was not in the affirmative action business. See U. S. Commission on Civil Rights, Home Ownership for Lower Income Families, pp. 84-7.

54. Feins, "Urban Housing Disinvestment," p. 230.

55. Ibid.

56. Hetland, "The California Land Contract," California Law Review 48 (1960), cited by Colvin, "The Provision for Mortgage Conversion and Title Conveyance in Installment Contracts For The Sale of Residential Property to Blacks in Chicago," unpublished paper, Contract Buyers League files, Chicago, April 10, 1970, pp. 41-50.

57. David S. Bogen and Richard V. Falcon, "The Use of Racial Statistics in Fair Housing Cases," Maryland Law Review 34 (1974), pp. 61- 6.

58. John Yinger, "Economic Incentives, Institutions, and Racial Discrimination: The Case of Real Estate Brokers," Discussion Paper D78-4, Department of City and Regional Planning, Harvard University (Cambridge: DCRP, February 1978), pp. 28- 9.

59. Robert Schafer, "Discrimination in Housing Prices and Mortgage Lending," Working Paper No. 59, Joint Center for Urban Studies of the Massachusetts Institute of Technology and Harvard University (Cambridge: JCUS, June 1979), p. 23- 5.