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Wholesale funding and the increase in construction bank-owned real estate in the US financial crisis

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ABSTRACT

The housing crisis left some metropolitan areas littered with partially constructed subdivisions and developments. Most of these failed developments were built by small construction firms reliant on small banks for finance. Failed construction projects became bank-owned real estate (REO), prolonging the crisis and contributing to an uneven recovery. But there is little research on the spatial distribution or financial processes driving construction REO. I use a finance-as-spatial fix theorization to describe increasing interrelation between construction lending and global capital markets through wholesale funding, and the subsequent buildup of construction REO. Wholesale funding allows small banks to access money markets. Controlling for economic growth, the home price bubble, and financial institutions, I use a national panel regression to identify key factors associated with high levels of construction REO in urban areas. Consistent with a finance-as-spatial-fix analysis, the strongest determinant of construction REO was the type of capital flows into small banks.

KEYWORDS:

Construction financialization REO housing banks

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Notes

1. President Obama has recently increased FDIC coverage to deposits of up to $250,000, but for the time frame of this study, the limit has been $100,000.

2. Conversations with bankers and sensitivity tests with the data suggest that this effect is probably around, but not specifically 6 years. I tested the lag using a fixed effect model and found similar results in the 5–8 year period. I chose 6 years to maximize the sample size.

3. I calculated this figure for the small urban banks in the sample for this paper, using 2006 FDIC call reports.