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Volume 38, 2017 - [Issue 9](#)

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

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Pages 1374-1392 | Received 06 Nov 2014, Accepted 23 Jun 2016, Published online: 14 Oct 2016

Cite this article <https://doi.org/10.1080/02723638.2016.1243187>



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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

Acknowledgements

I would like to thank Dr. Manuel Aalbers, Dr. Patrick Le Galés and other participants in the Real Estate/Financial Complex & Urban Policy seminar at KU Leuven, three anonymous peer reviewers for their thoughtful review and suggestions as well as to Dr. Carl Hudson, Director of the Center for Real Estate Analytics at the Federal Reserve Bank of Atlanta for encouraging my interest in the banking system. Finally, thanks to my advisor, Dr. Dan Immergluck, Professor of City Planning at Georgia Institute of Technology, for his patient advice and encouragement. All mistakes are my own.

Disclosure statement

No potential conflict of interest was reported by the author.

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.

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