

Professor Chris Mayer

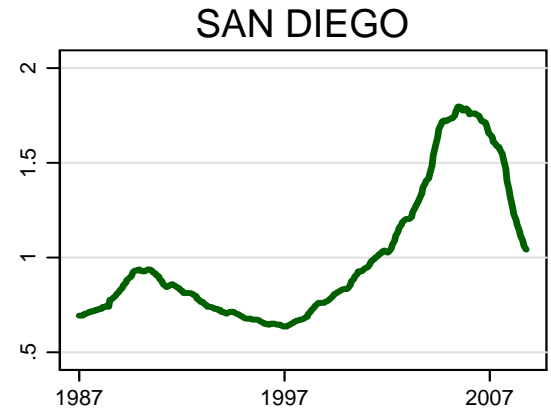
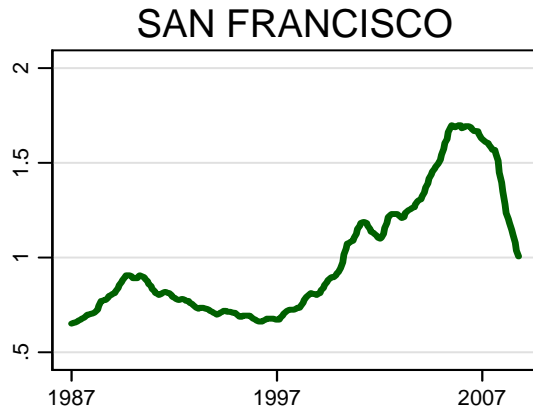
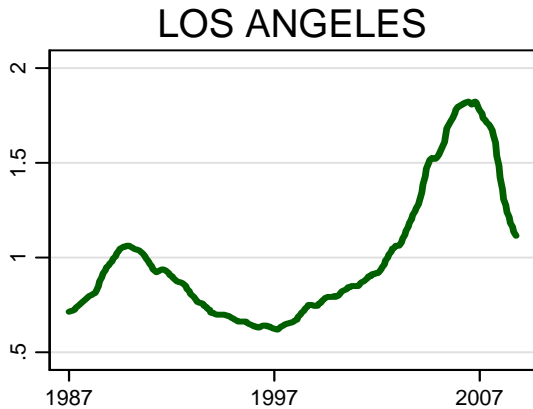
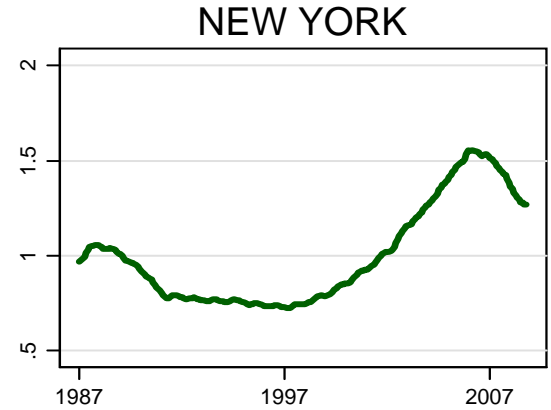
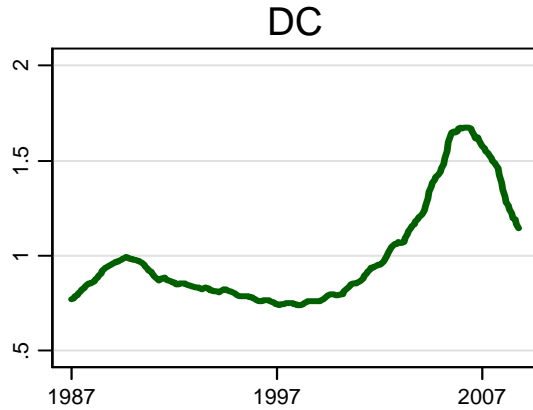
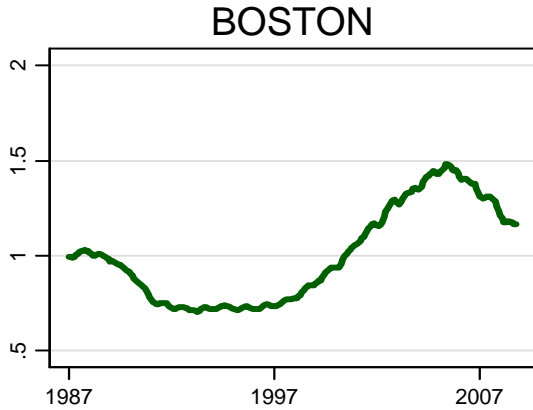
(Senior Vice Dean, Columbia Business School and NBER)

Public Policy Responses to the Housing and Foreclosure Crisis

We are in a major housing crisis!

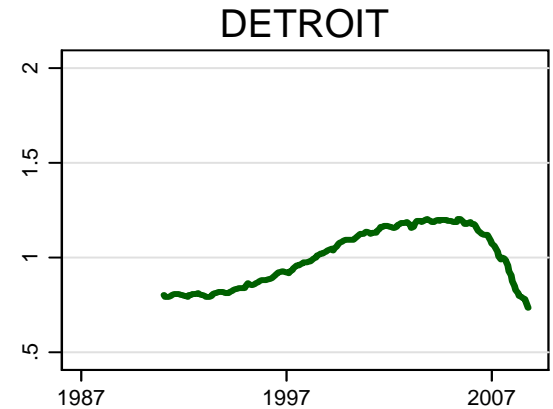
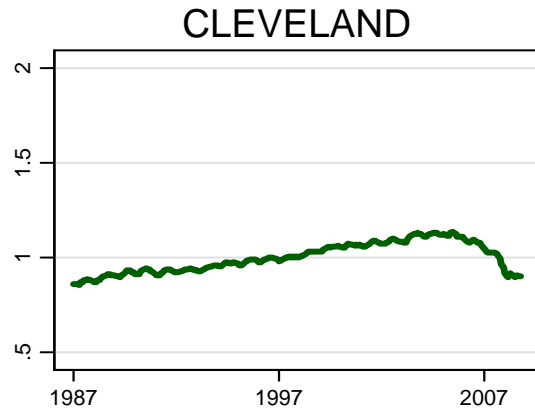
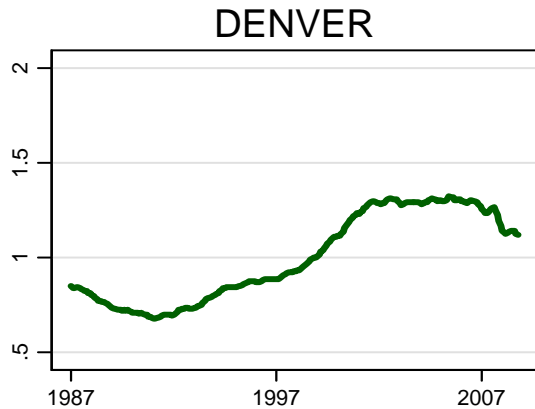
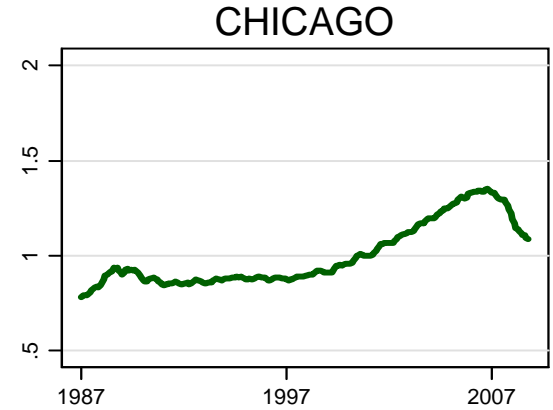
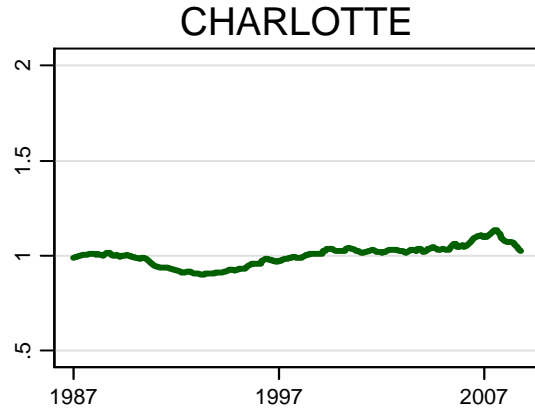
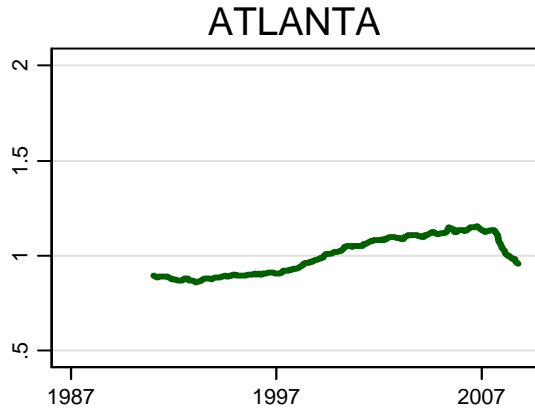
**Housing problems are destroying
our financial system and
hammering consumers!**

Panel A: Real House Prices for Cyclical Markets: 1987 to present



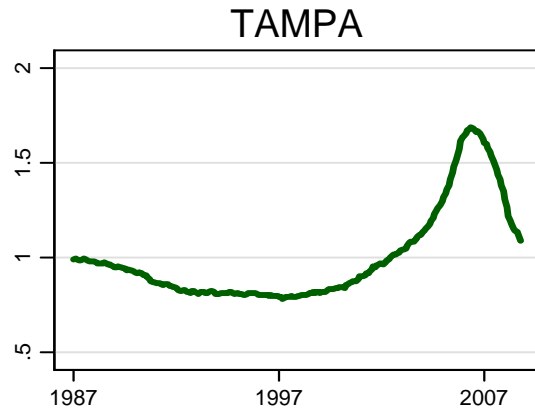
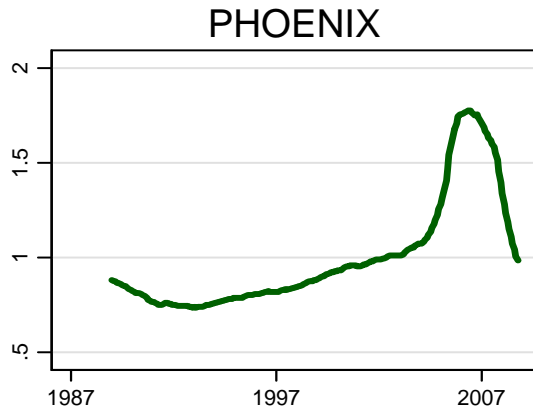
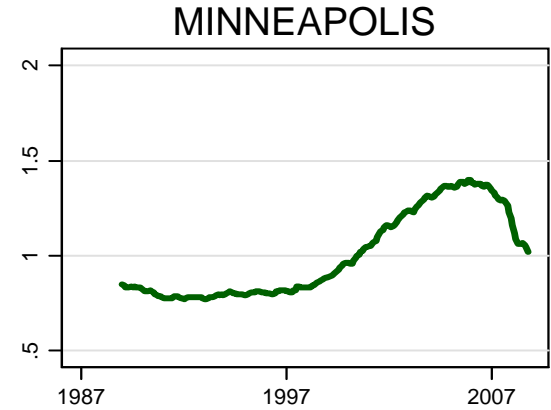
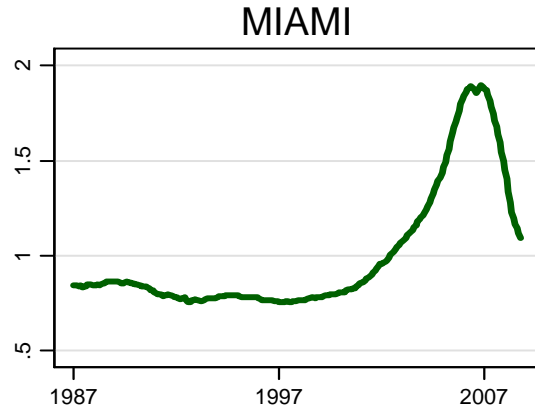
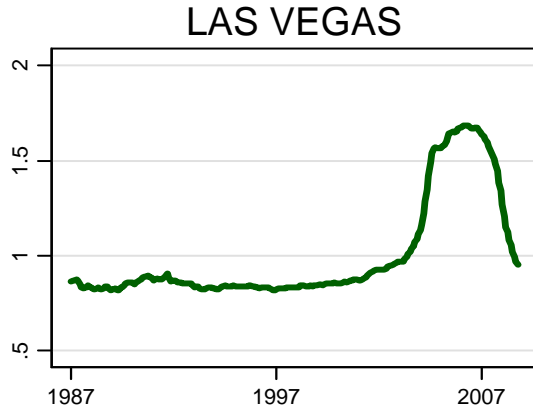
— Case-Shiller

Panel B: Real House Prices for Steady Markets: 1987 to present



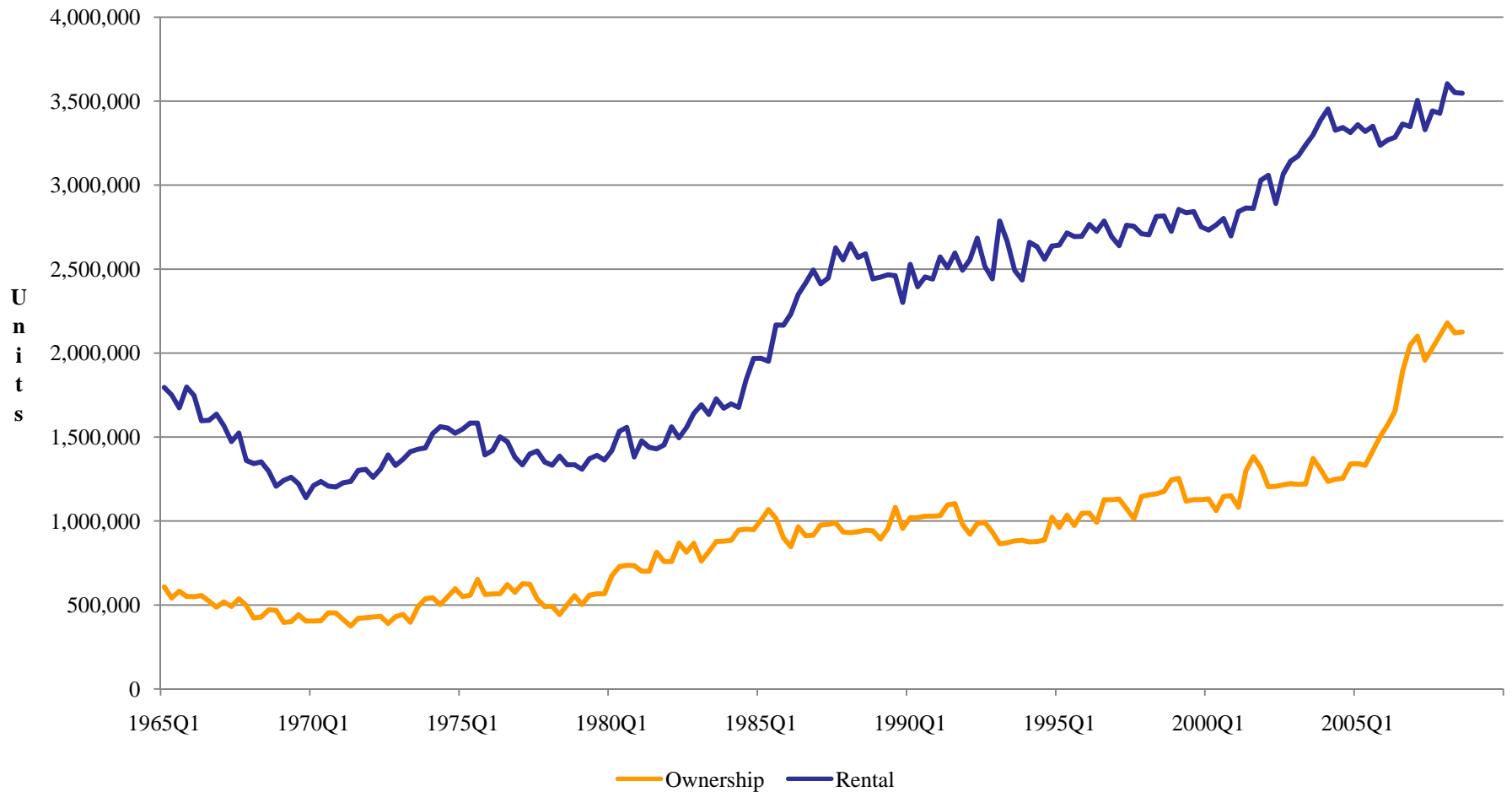
— Case-Shiller

Panel C: Real House Prices for “Recent Boomers”: 1987 to present



— Case-Shiller

Vacant housing at an all-time high!



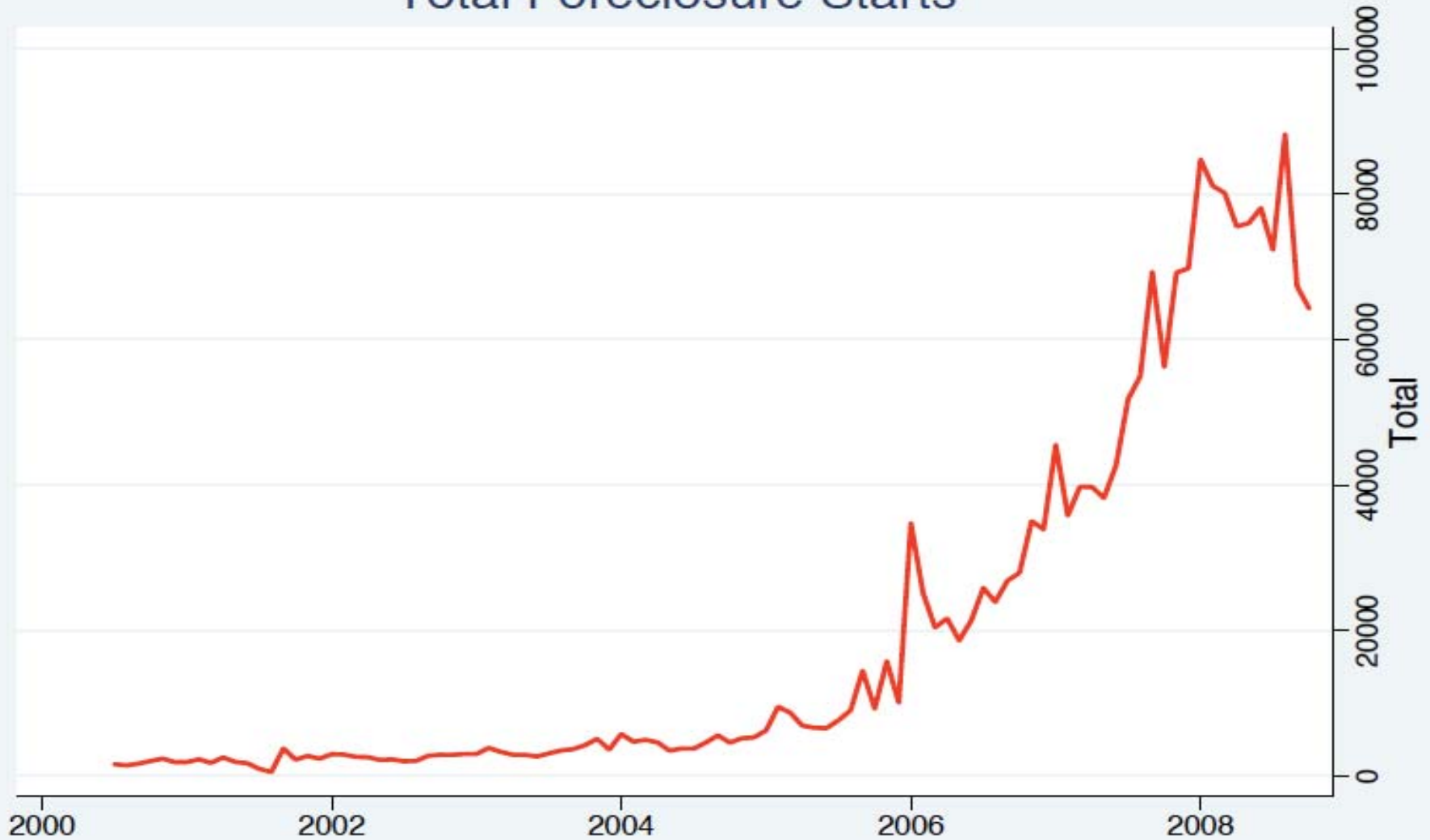
Current as of Quarter 3, 2008

Source: US Census

US Residential Vacancy

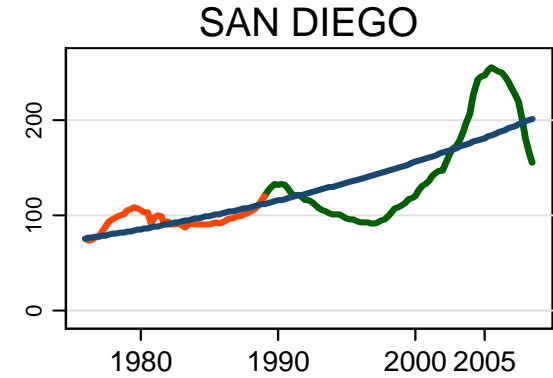
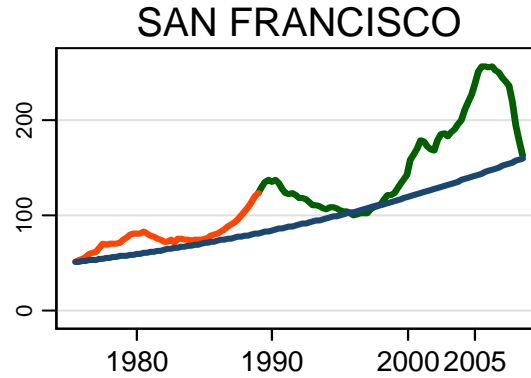
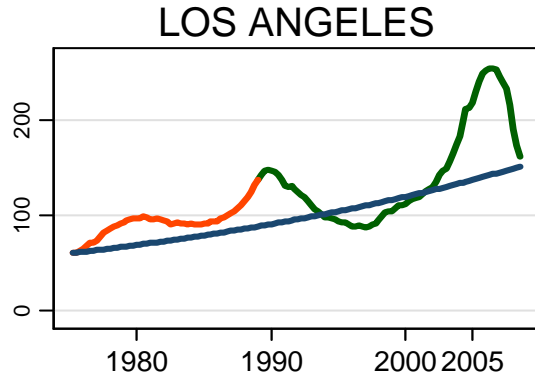
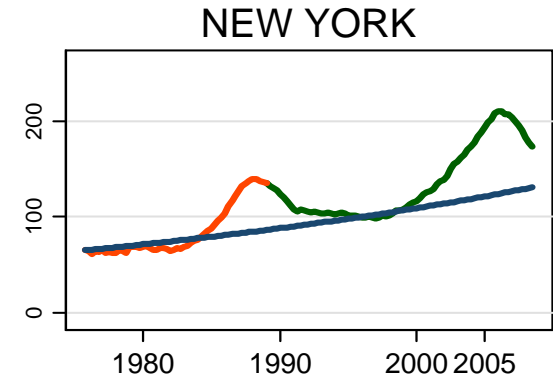
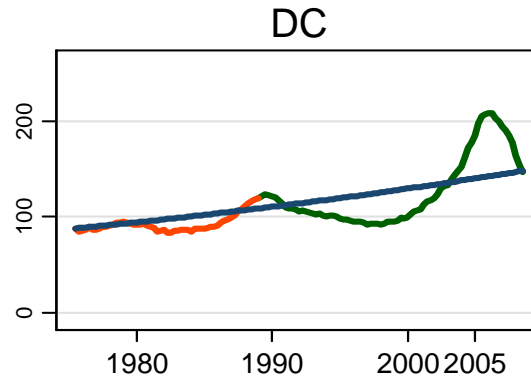
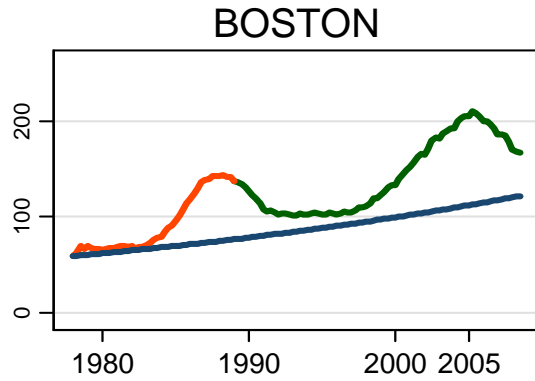
Foreclosures have skyrocketed!

Total Foreclosure Starts



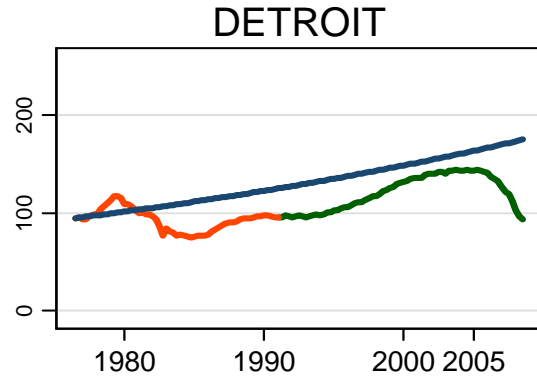
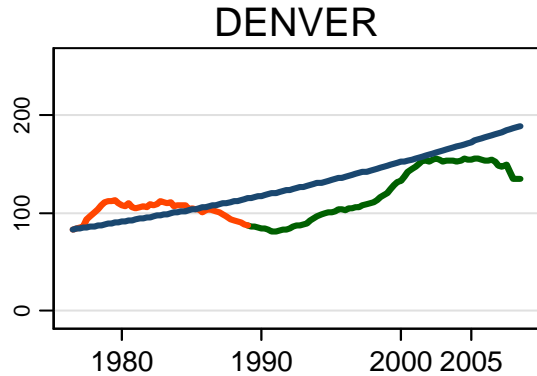
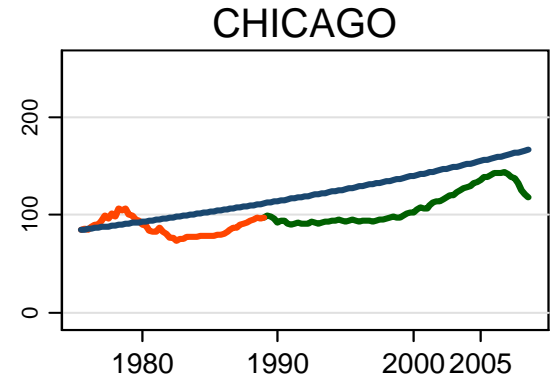
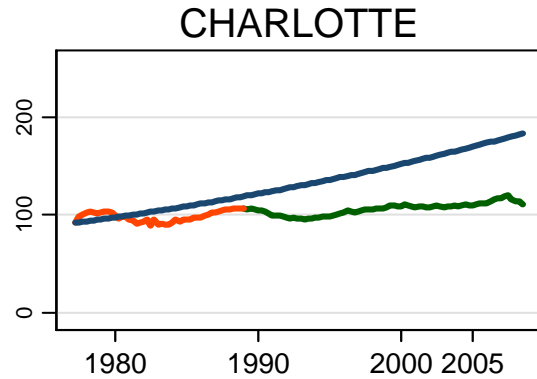
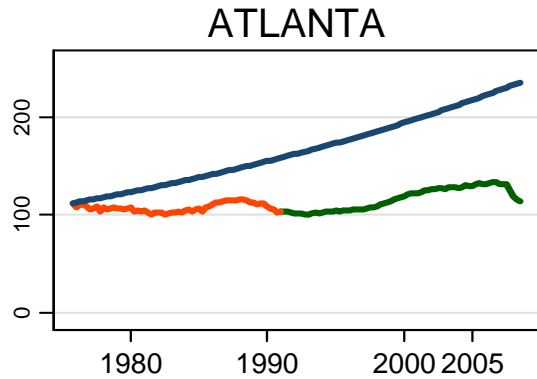
House prices in most markets have fallen close to their real value prior to the boom

House Prices in Cyclical Markets



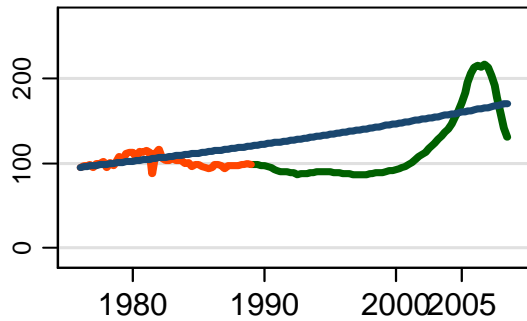
Source: OFHEO, Case-Shiller Index and BLS
 OFHEO Index Current as of Quarter 3 2008
 Case-Shiller Index Current as of September 2008
 Real Home Price Index

House Prices in Steady Markets

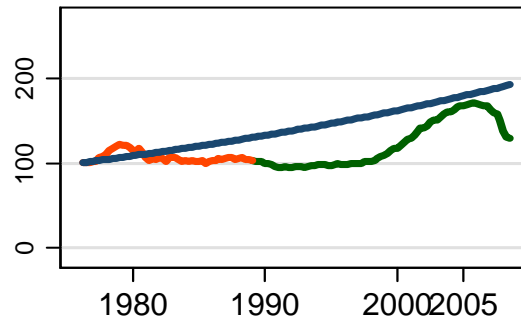


House Prices in “Bubble” Markets

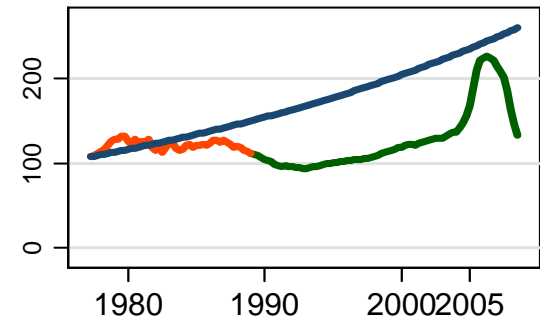
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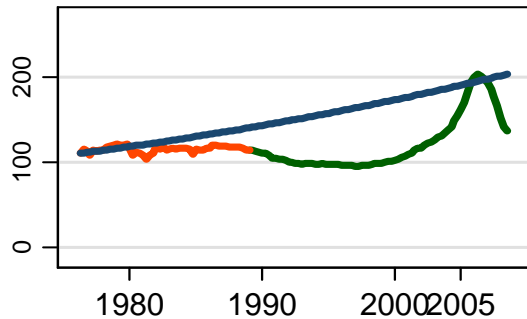
MINNEAPOLIS



PHOENIX



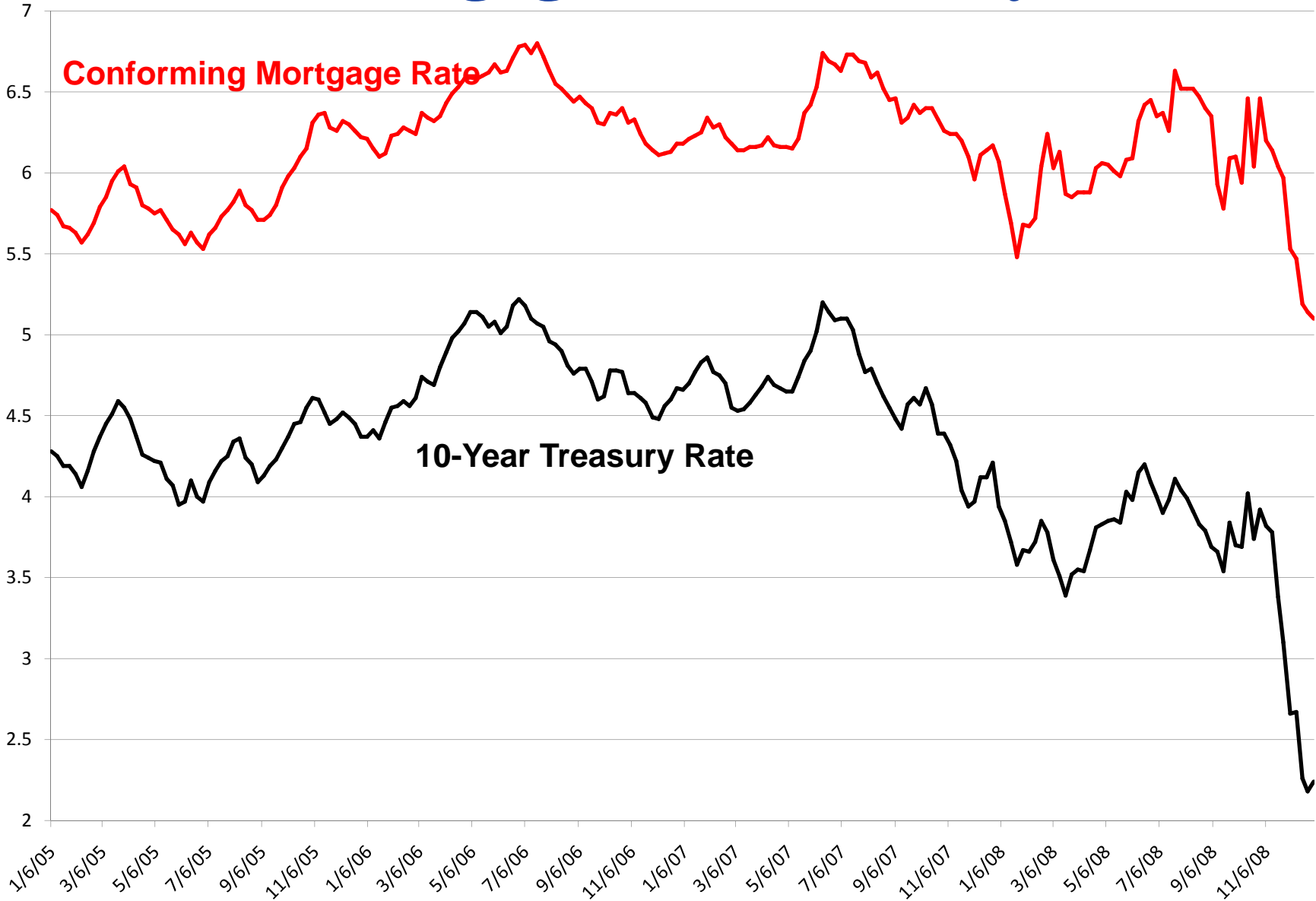
TAMPA



Source: OFHEO, Case-Shiller Index and BLS
 OFHEO Index Current as of Quarter 3 2008
 Case-Shiller Index Current as of September 2008
 Real Home Price Index

- September, 2008
- The Government takes conservatorship of GSEs...
- And mortgage rates go up!

Mortgage and Treasury Rates



Spread between conforming mortgage rate and 10-year Treasury



Today...

- 30-year fixed-rate mortgage is **5.01%** (lowest rate since 1930s)
- Nonetheless, mortgage rates should be even lower
- 10-year US Treasury bond is **2.41%**
- **So FRM rates should be 100 basis points lower (about 4%)**
- Think of the fiscal stimulus from those rates...

Mortgage Market Meltdown and House Prices: Imputed Rent-to-Rent Ratio

Imputed-Rent to Rent Ratio			
	Historical	2008 Q3	Difference
Spread	1.60	2.45	
ATLANTA	0.93	1.07	16%
BOSTON	0.92	1.06	15%
CHARLOTTE	0.91	1.06	16%
CHICAGO	0.99	1.11	13%
CLEVELAND	0.87	0.97	12%
DC	0.89	1.02	14%
DENVER	0.94	1.10	16%
DETROIT	0.78	0.88	12%
LOS ANGELES	0.86	1.02	19%
MIAMI	0.95	1.07	13%
MINNEAPOLIS	0.97	1.10	14%
NEW YORK	0.85	0.96	13%
PHOENIX	0.89	1.05	18%
SAN DIEGO	0.79	0.95	21%
SAN FRANCISCO	0.76	0.95	25%
TAMPA	0.95	1.08	13%

So what should policy makers do?

- **“Hubbard-Mayer” proposal**
- Fix the mortgage market: lower mortgage spreads to their 20-year average of 1.6 percent prior to the crisis (**mortgage rate near 4% today**)
- Create modern HOLC to share losses on negative equity (similar to “Hope for Homeowners” but less punitive for lenders)
 - Lenders write-off one-half the loss
 - Taxpayers pay half the loss, get some future appreciation on the house
 - Borrower gives up future appreciation for the loss write-down

Cost of the proposal

- Lower mortgage rates do not cost the government as it would return mortgage market to normal functioning
- Increased government balance sheet use is offset by tangible assets (newly underwritten mortgages with borrowers who have verified income)
- HOLC provision costs \$121 billion, but taxpayers receive future equity to offset this expense

Why do this?

- *No private mortgage market*: Govt is originating more than 90% of mortgages, so it is setting rates
- *Hold up house prices by 10-17 percent nationally* relative to where they would fall if the mortgage market remains broken
 - 20% house price decline led to \$600 billion in losses for banks, what if prices fall another 15%?
 - Taxpayers on the hook for nearly \$6 trillion in guarantees due to Fannie, Freddie, Ginnie, AIG, and NY Fed...

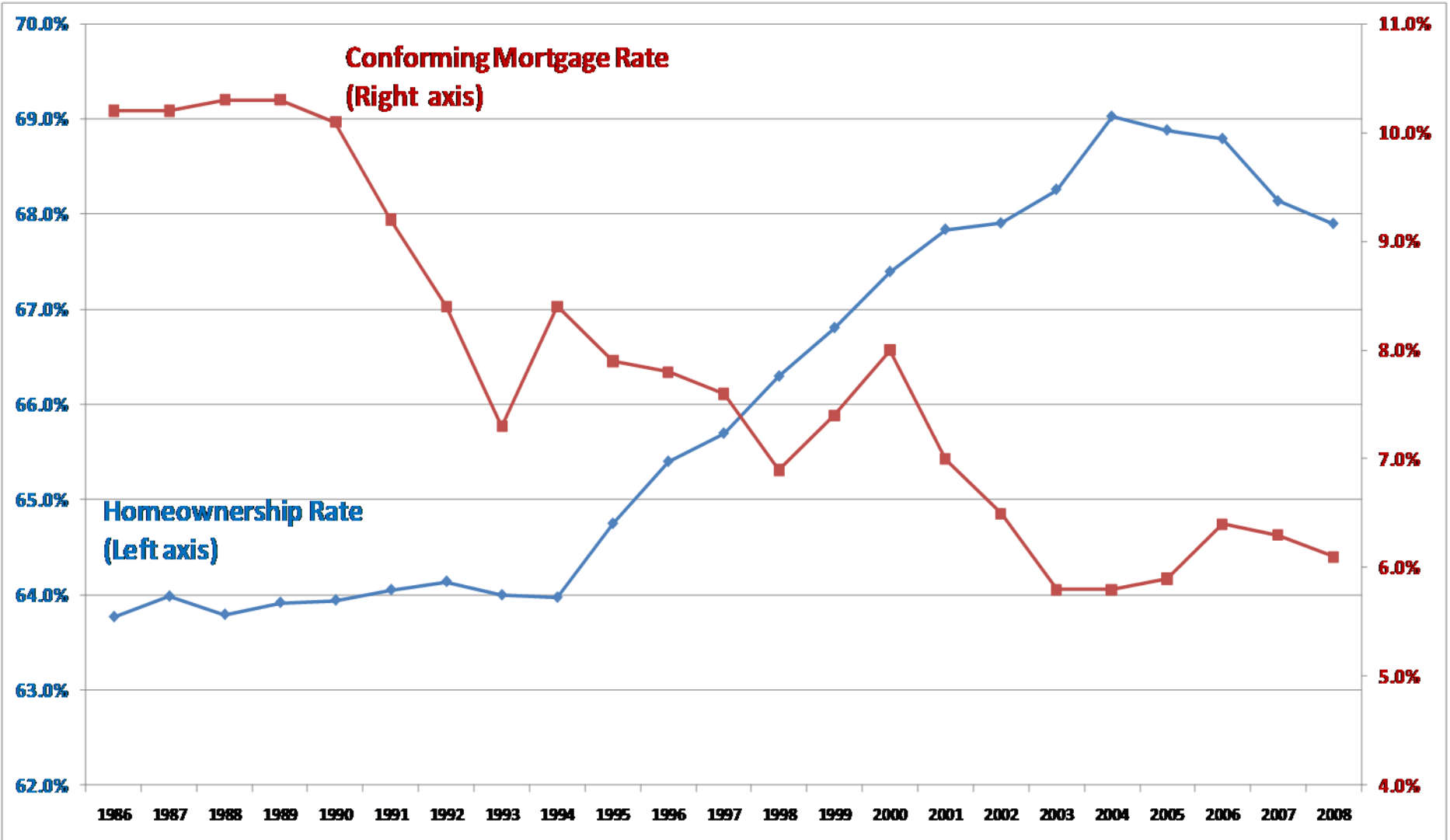
Macroeconomic stimulus

- Reduce mortgage payments by **\$175 billion *per year***
 - 25-34 million homeowners can refinance existing mortgages
 - Average saving of \$425/month
- Additional **wealth effect of \$60 billion** thru reduced house price declines of \$1.8 trillion (with a marginal propensity to consume from housing wealth of 3.5%)

Other benefits

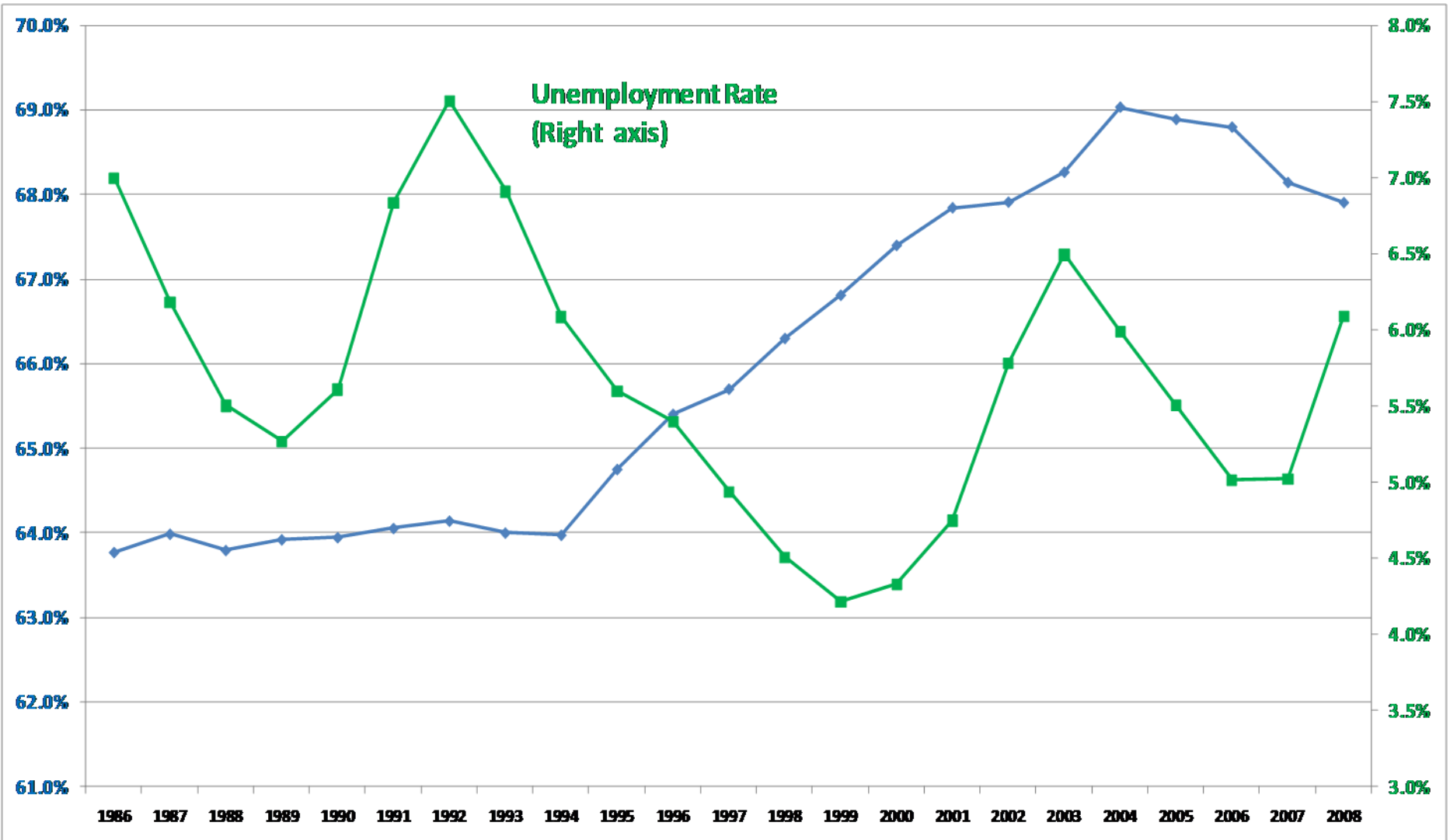
- Help make houses affordable for first-time buyers
- Dramatic program to improve confidence in the housing market
- Remove millions of mortgages from troubled and conflicted servicers
- Refinance borrowers into 30-year, fixed-rate mortgages
- Benefits many homeowners, not just the most over-levered borrowers

Homeownership rate appear strongly linked to mortgage rate



(sources: US Census Bureau and Freddie Mac)

Homeownership rate appear weakly linked to unemployment rate



(sources: US Census Bureau and Freddie Mac)

What about foreclosures?

- Mayer, Morrison, Piskorski proposal
 - Align servicers interests with investors: Create a fund to pay servicers for collecting payments or prepayments from borrowers (\$9.0 billion)
 - Create a legal “Safe Harbor” for servicers to maximize returns to investors as a group
 - Clarify servicers duty to maximize returns to all investors (positive NPV modifications)
 - Eliminate contractual restrictions against modification in 1/3 of securitizations
 - Compensate investors whose interests are harmed from contract modification (\$1.7 billion)

How do we align incentives?

- Currently servicers receive portion of outstanding mortgage balances
 - No payments to modify loans
 - Receive cost reimbursement for foreclosures
- Our plan pays servicers an Incentive Fee (10% of mortgage payments, capped at \$60/month)
 - Incentive to modify loans only when necessary (maximize borrower payments)
 - Servicers only receive Incentive Fees if borrower makes payments (successful modifications)
 - Additional payments for successful “short sales”

Costs/Benefits of our proposal

- Must address foreclosures
 - Negative externality on other homeowners and financial system
 - Inefficient and socially costly to kick borrowers out of their homes when alternatives are possible
- Reduce up to 1 million foreclosures at a cost of \$10.7 billion
- Much less expensive than other plans: TARP Reform bill proposes minimum of \$40 billion up to \$100 billion to reduce foreclosures

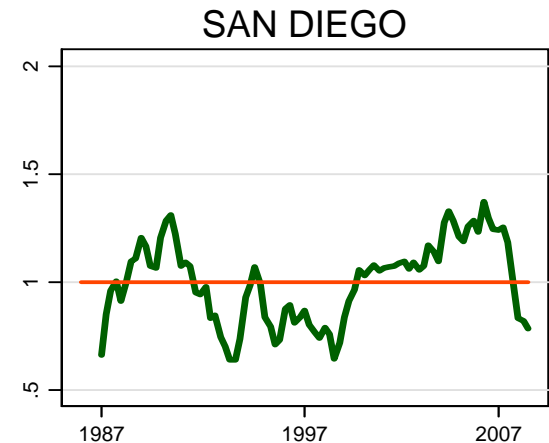
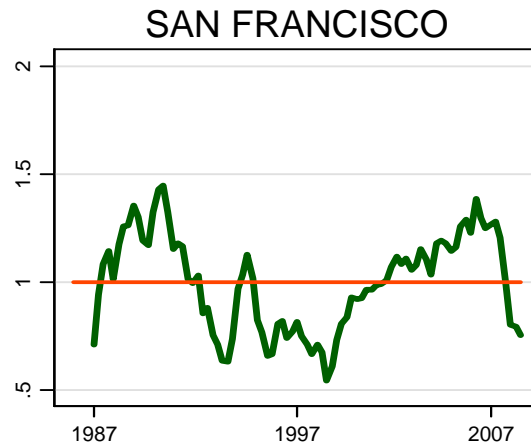
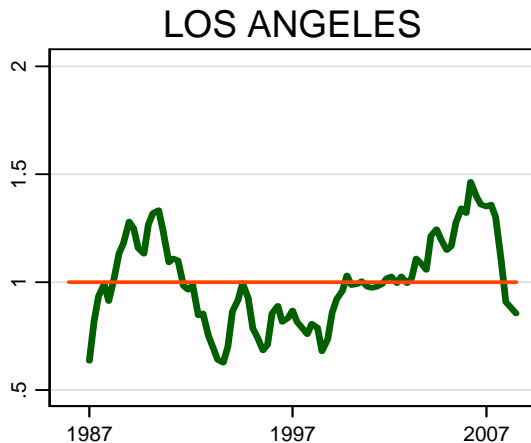
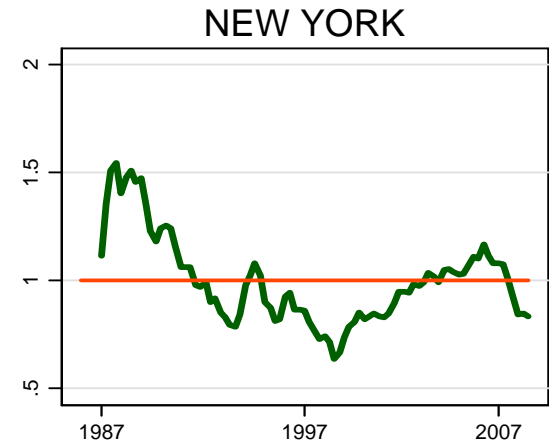
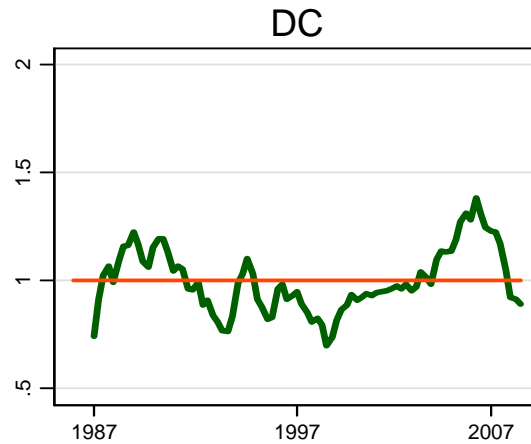
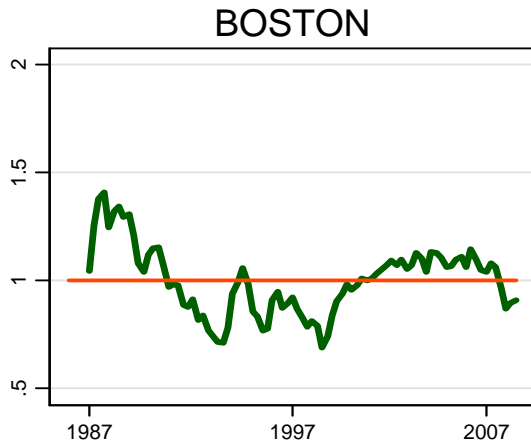
Other policies are much worse

- Bankruptcy “cramdowns” are not the answer
 - Moral hazard: 4 million delinquent loans, 51 million loans that are current
 - More costly mortgages in the future
 - Extend credit crisis with millions of foreclosures
 - Servicers would be paid to push borrowers into bankruptcy instead of modifying loans
- FDIC/Sheila Bair proposal
 - Costly mortgage guarantees (\$70 billion or more)
 - Pay servicers to modify loans, but no incentive for successful modifications

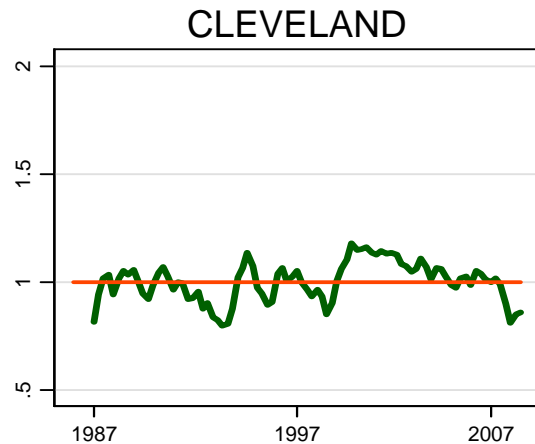
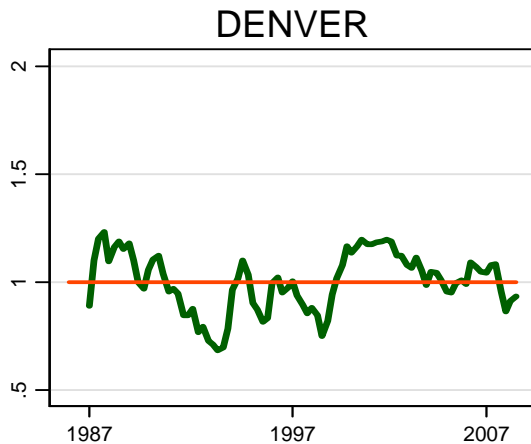
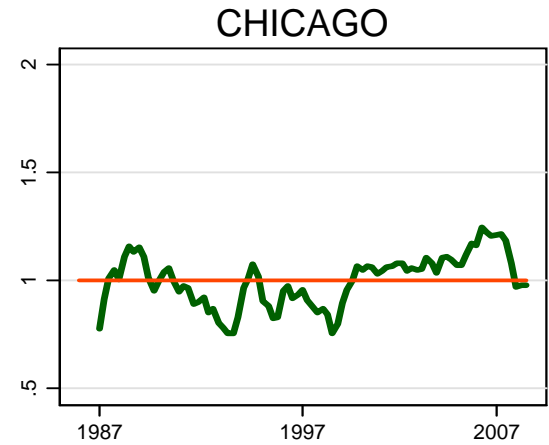
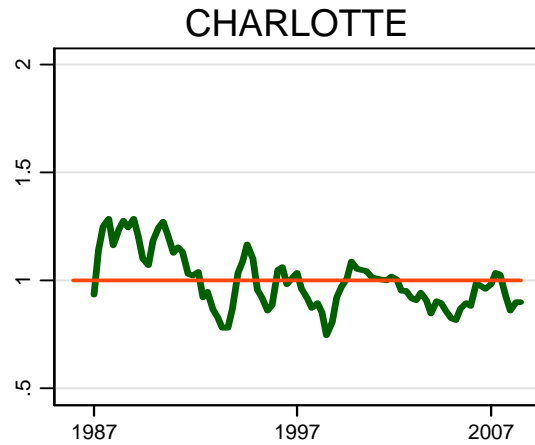
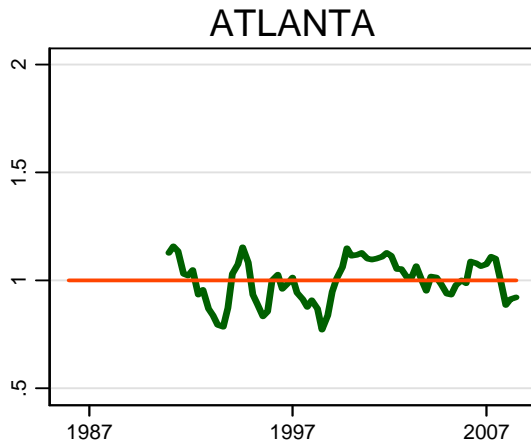
Conclusions

- House prices are sensitive to interest rates
- Malfunctioning credit markets are hammering US house prices, even in markets with little exposure to subprime lending
- Government intervention can immediately ensure more normal functioning mortgage and housing markets, saving millions from foreclosure
- Foreclosure prevention through re-working servicer incentives and legal agreements
- Covered bond-like structure may provide a new model for residential and commercial mortgages

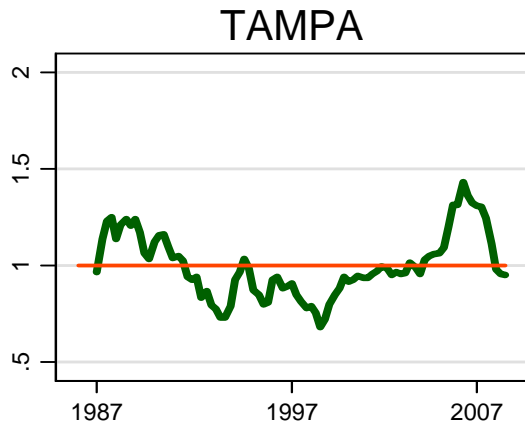
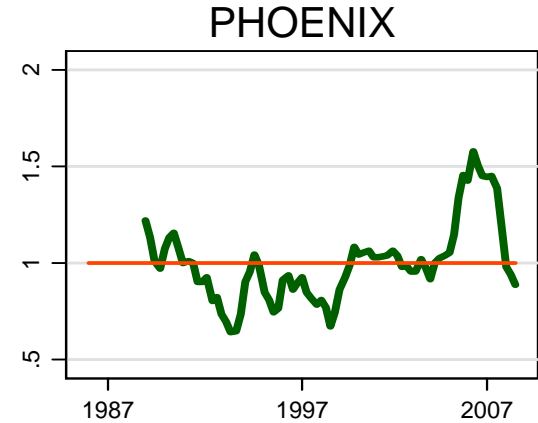
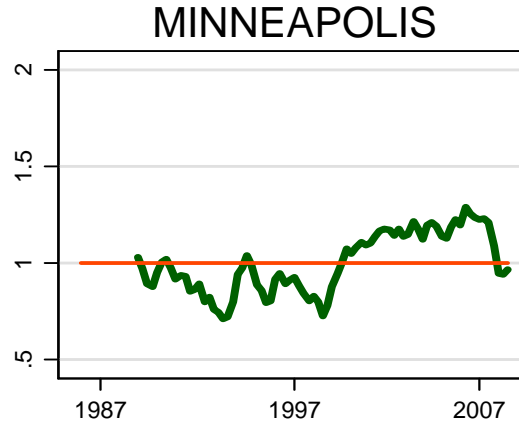
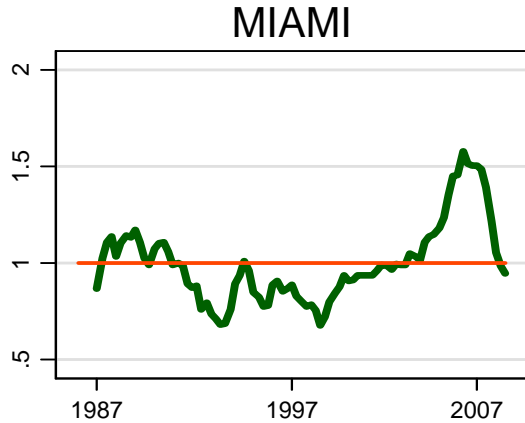
Imputed Rent to Rent



Imputed Rent to Rent

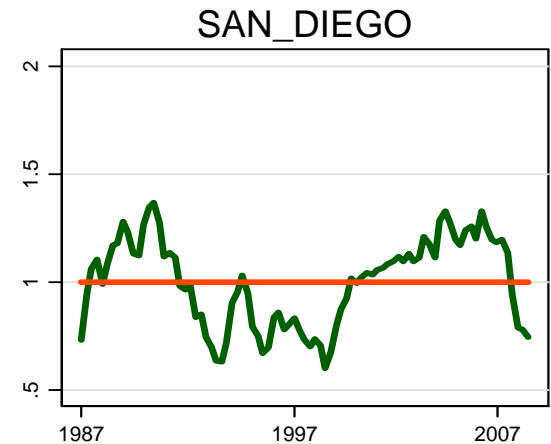
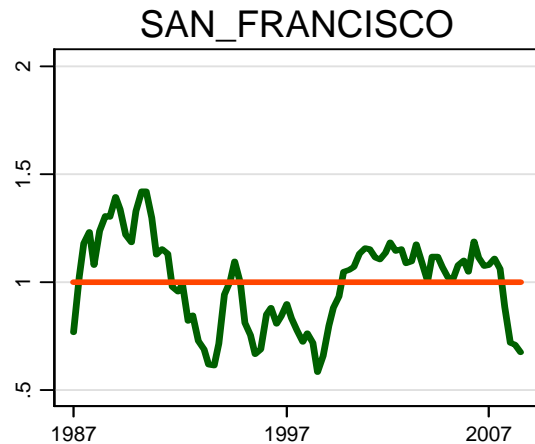
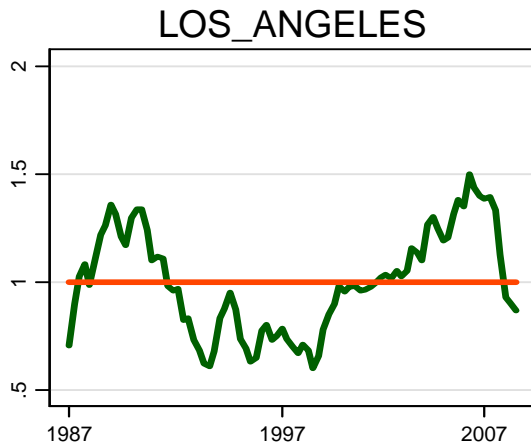
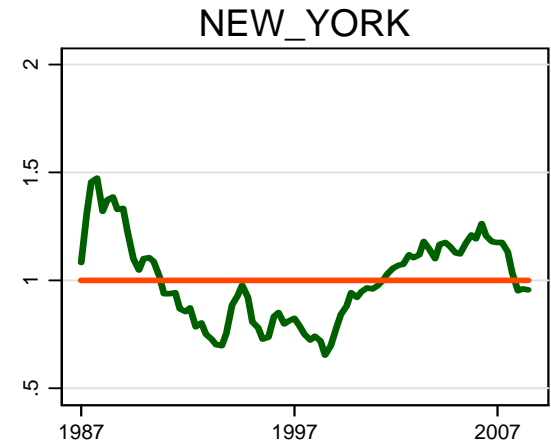
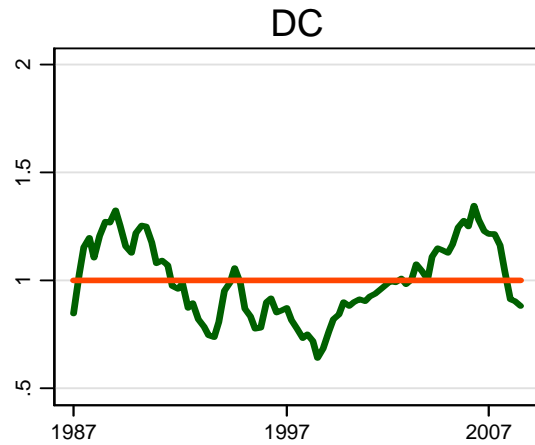
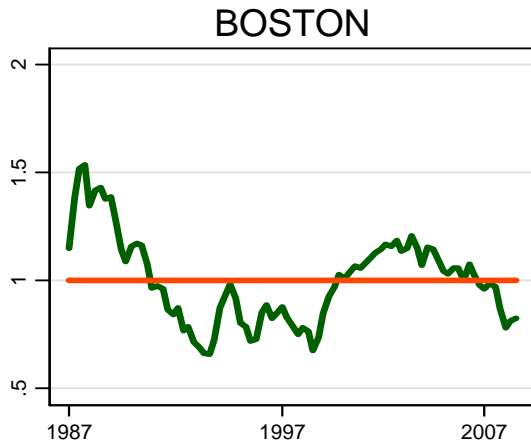


Imputed Rent to Rent

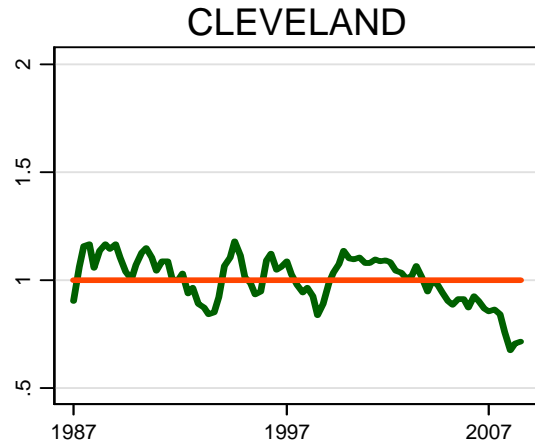
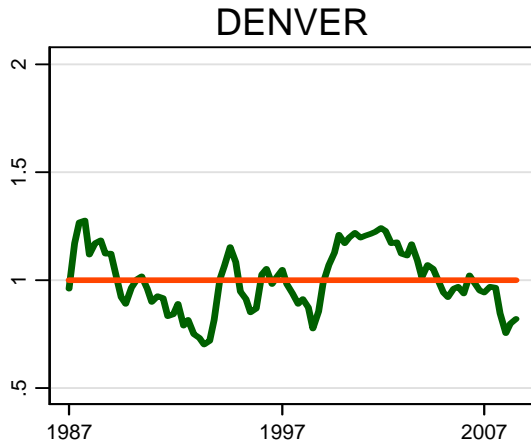
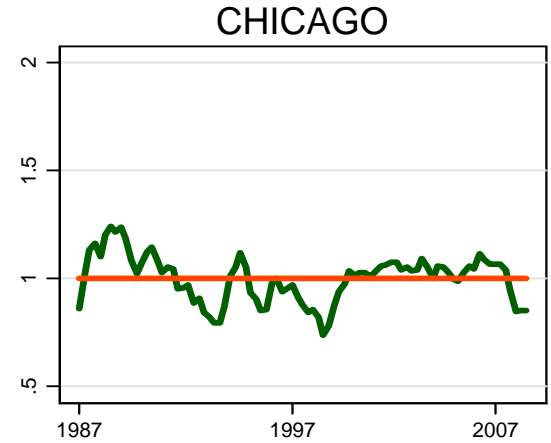
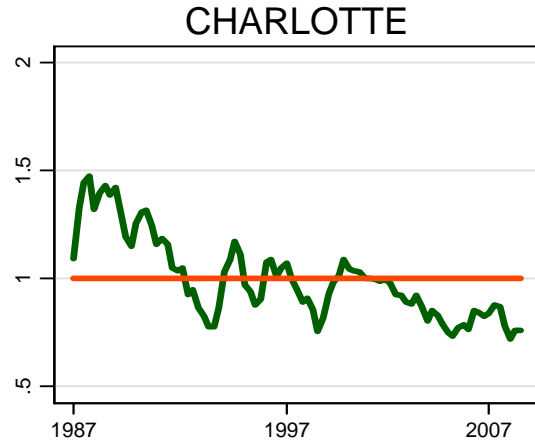
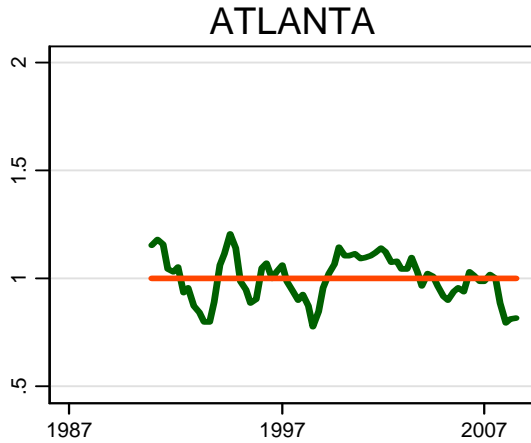


Current as of September, 2008
Imputed Rent to Rent, Case-Shiller
Rent data is not available for the Las Vegas MSA
Index = 1: 20-Yr Average

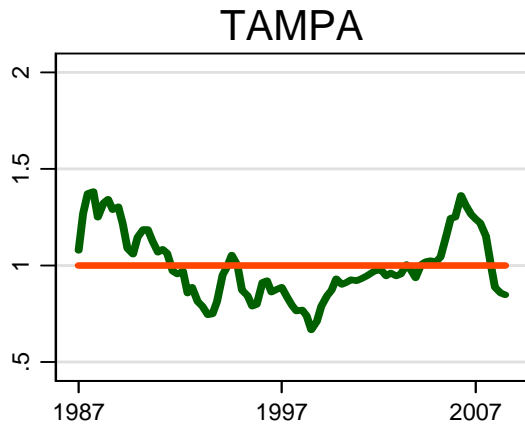
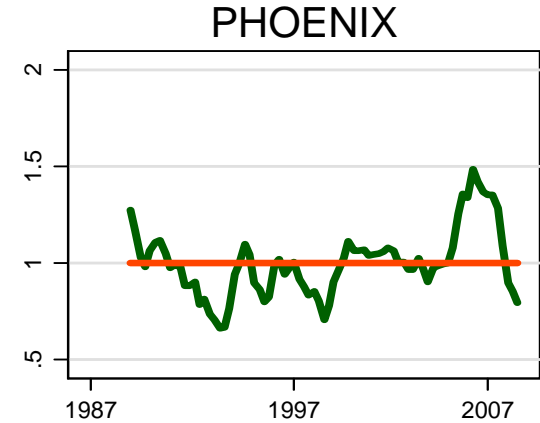
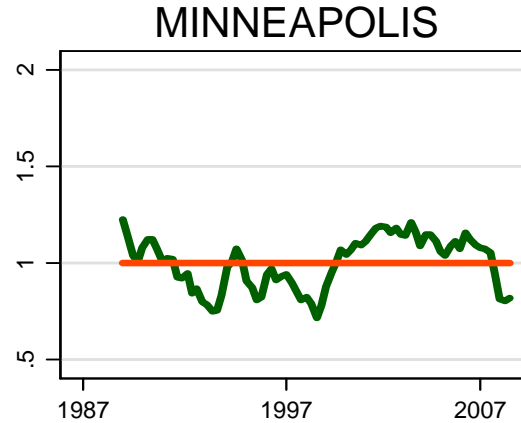
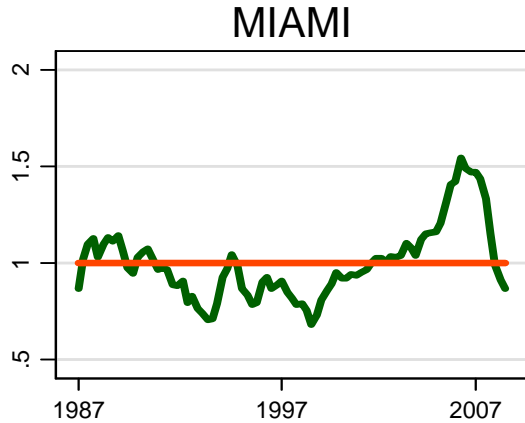
Imputed Rent to Income



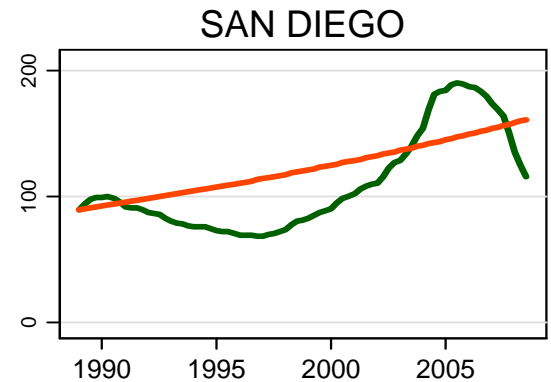
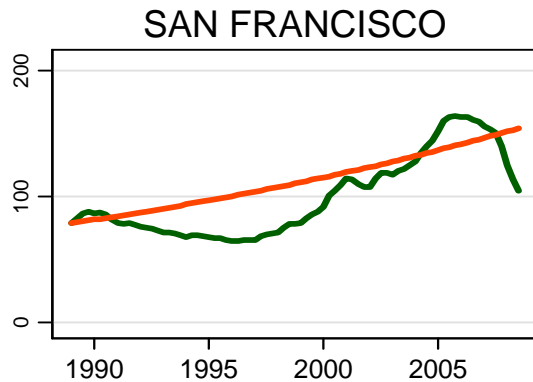
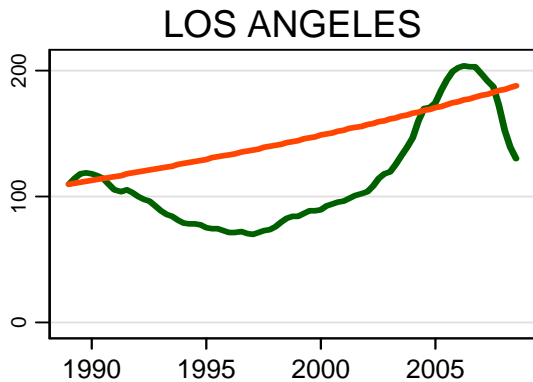
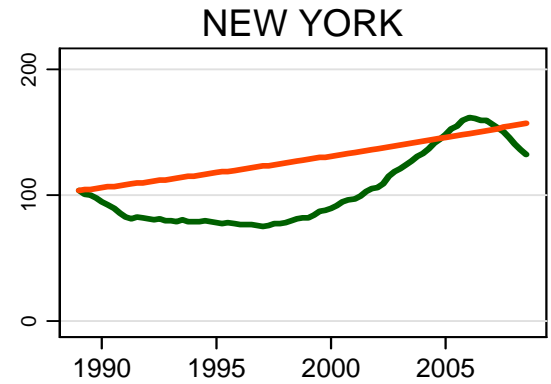
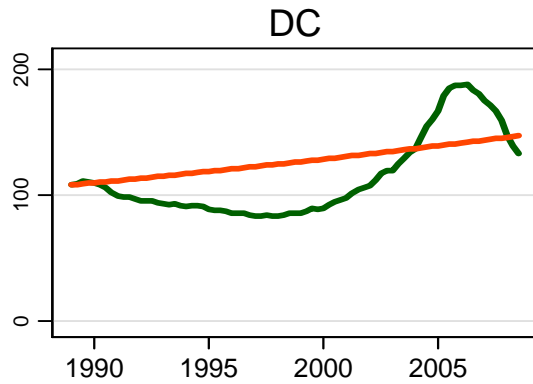
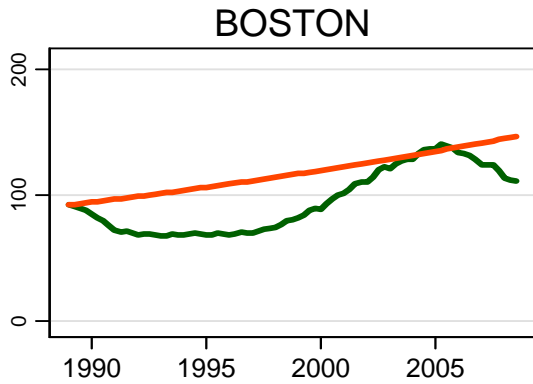
Imputed Rent to Income



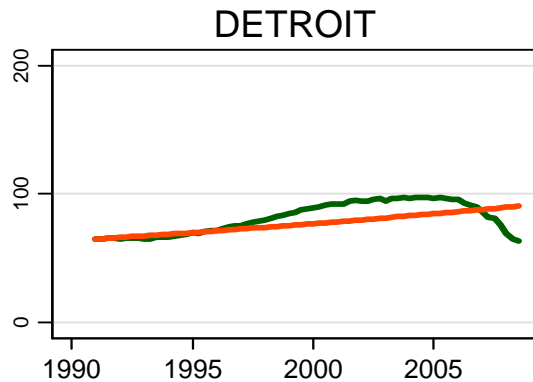
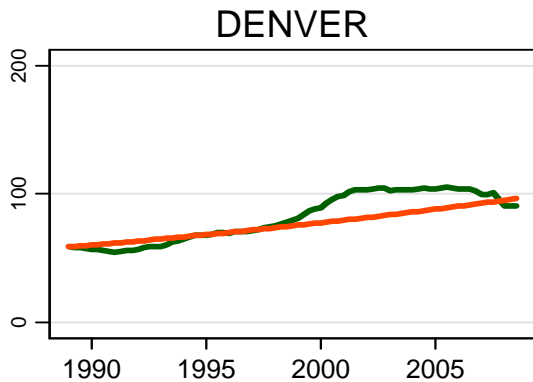
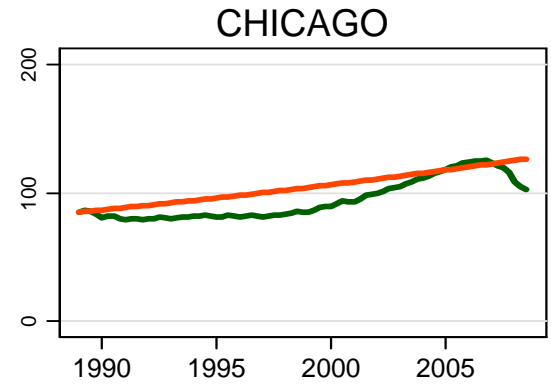
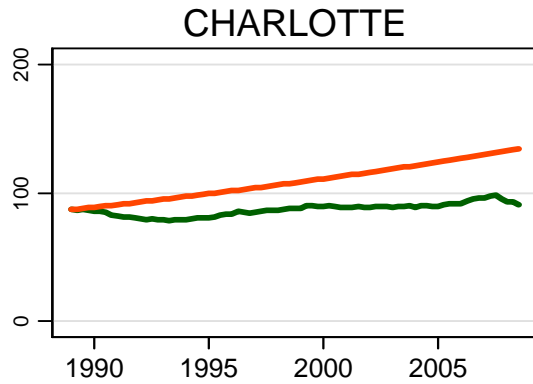
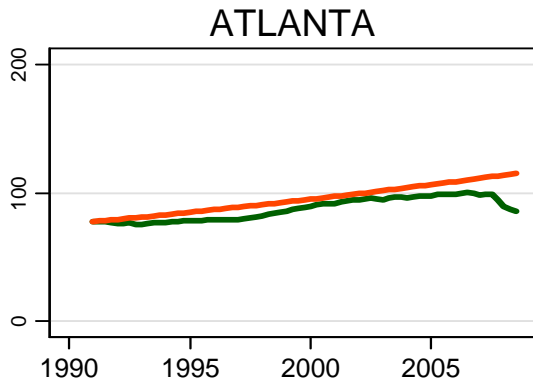
Imputed Rent to Income



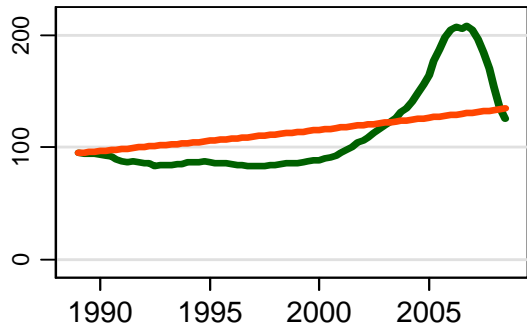
Current as of September, 2008
Imputed Rent to Income, Case-Shiller
Rent data is not available for the Las Vegas MSA
Index = 1: 20-Yr Average



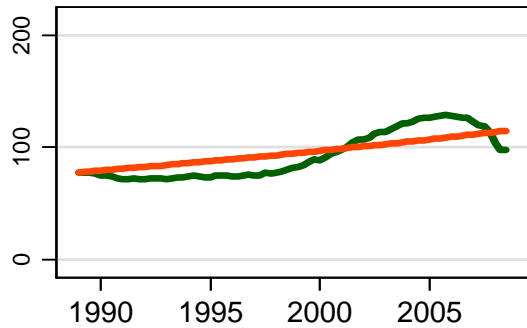
Source: Case-Shiller Index and BLS
 Case-Shiller Index Current as of September 2008
 Real Home Price Index
 Index = 1: Sample Average



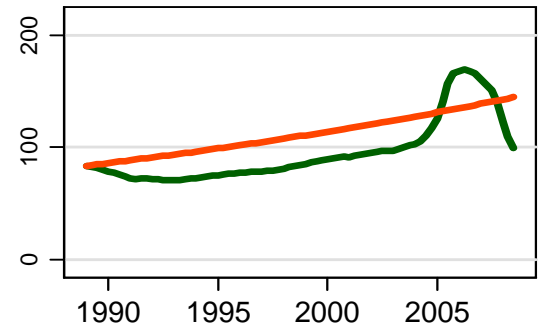
MIAMI



MINNEAPOLIS



PHOENIX



TAMPA

