Federal Reserve Bank of Atlanta
Real Estate Finance Conference

Housing Finance Reform: Policy Options for an Informed Market

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Housing Finance Revolution: global capital market integration and systemic risk

- Rationed and segmented housing finance until ‘90s
- Incomplete real estate – consequential with leverage

- Financial accelerator
  - 1990s: Japan
  - 1997: Asian Financial Crisis
  - 2007: Subprime Crisis US
  - Simultaneous bubbles in UK, Ireland and Spain (Bank-led)

- Credit propagates asset bubbles: systemic risk episodes result
The Pavlov-Wachter Indicator of Underpricing of Risk

• **Ex ante, the Pavlov-Wachter Indicator** correlation between declines in the credit risk premium and increases in the price to rent ratio predicts the depth of price decrease during the decline.

Price to Rent Ratio Estimated Using PLS Share of Overall Securitization in the US Subprime Crisis

Shrouded Information in US Mortgage Markets

- Mortgage terms and rates – unknown
- Household leverage with CLTV – unknown
- Financial firms counterparty risk – unknown
- In the absence of information, more risk production-CDS marked to model not to market

Consensus and Dissensus

• Informed markets: FSOC, OFR, QM, stress test

• Structural reform of GSEs
  – TBA-who has access
  – Catastrophic insurance- who pays and who must have
  – Private risk capital-regulation

• Watt: “We’ve tried out a number of risk sharing methods. We are concerned that the private sector, the capacity of the private sector, to take on this risk, particularly in a economic downturn and a distress situation concern us greatly.” Congressional testimony 12/8/2016
Policy Alternatives

• Status quo
  – FHFA oversight of Fannie and Freddie
    • With credit risk transfer and single security
    • With front end (CRT) and common security platform in discussion (Johnson/Crapo)
• Recap and release
• Cooperative/Mutual
Limbo, a good place to be?

- Fannie/Freddie/Ginnie are insuring over 70% of mortgage market 5 plus trillion dollars with a government guarantee in place.

- Fannie/Freddie repaid $200 billion plus $50 billion in profit to treasury

- Original 2013 Bipartisan legislation cosponsored by Corker (R) and Warner (D) died

- Housing industry (NAHB, NAR) weigh in favor of Jumpstart legislation- precludes White House recap and release.

- White House says will do nothing without comprehensive congressional reform.
Advocates and community lenders say....

- League of United Latin American Citizens (LULAC), the National Community Reinvestment Coalition (NCRC), and the National Association for the Advancement of Colored People (NAACP): “we urge the administration to begin the recapitalization of the enterprises (NCRC, NAACP)”

- African American Mayors Association (AAMA): “release Fannie Mae and Freddie Mac from conservatorship and allow them to rebuild their capital”

- Community Home Lenders Association (CHLA): “Congress should direct the FHFA to develop a plan to show how the GSEs could be recapitalized”

- The Community Mortgage Lenders of America (CMLA): “The CMLA is repeating its call for Treasury to take immediate corrective action to cure the undercapitalization of the GSEs.”

- Hispanic Federation: “restore Fannie Mae and Freddie Mac to independence”
Stalemate, but…

• Mel Watt (FHFA Director) at House Financial Services Committee hearing
  “Staying in conservatorship is just not sustainable. You have a high risk of losing the
  most qualified people to the private sector. Congress should act.”

• Antonio Weiss at The Consumer Federation of America’s Annual Financial Services
  Conference (12/4/2015)
  – “At the same time, we continue to work through complex policy questions about how
    best to shape the contours of a future housing finance system.
  – These are important questions to consider:
    • Are there alternative structures that can limit risk to taxpayers while ensuring
      broad access to credit?
    • For example, could a mutual or cooperative approach play a role in a future
      system?
    • And, how best can we utilize the GSEs’ existing infrastructure and systems?”
Perspective on Housing Risk Information

• Good news about information

• HMDA, OFR, NMDB

• GSEs loans

• Market pricing of risk: CRT
Thank you

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