
Federal Reserve Bank of Atlanta Real Estate Finance Conference

Housing Finance Reform: Policy Options for an Informed Market

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Susan M. Wachter

Sussman Professor

Professor of Real Estate and Finance

The Wharton School, University of Pennsylvania



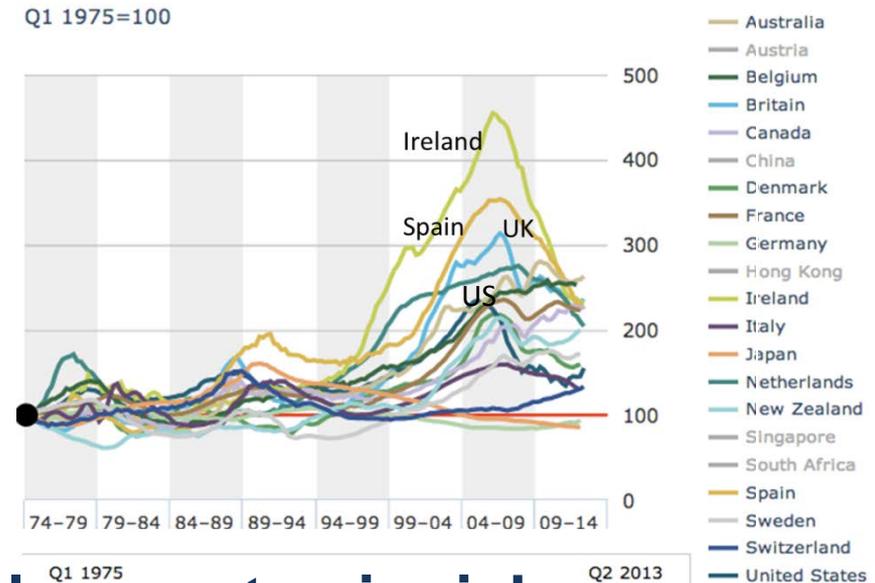
Housing Finance Revolution: global capital market integration and systemic risk

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

- **Financial accelerator**

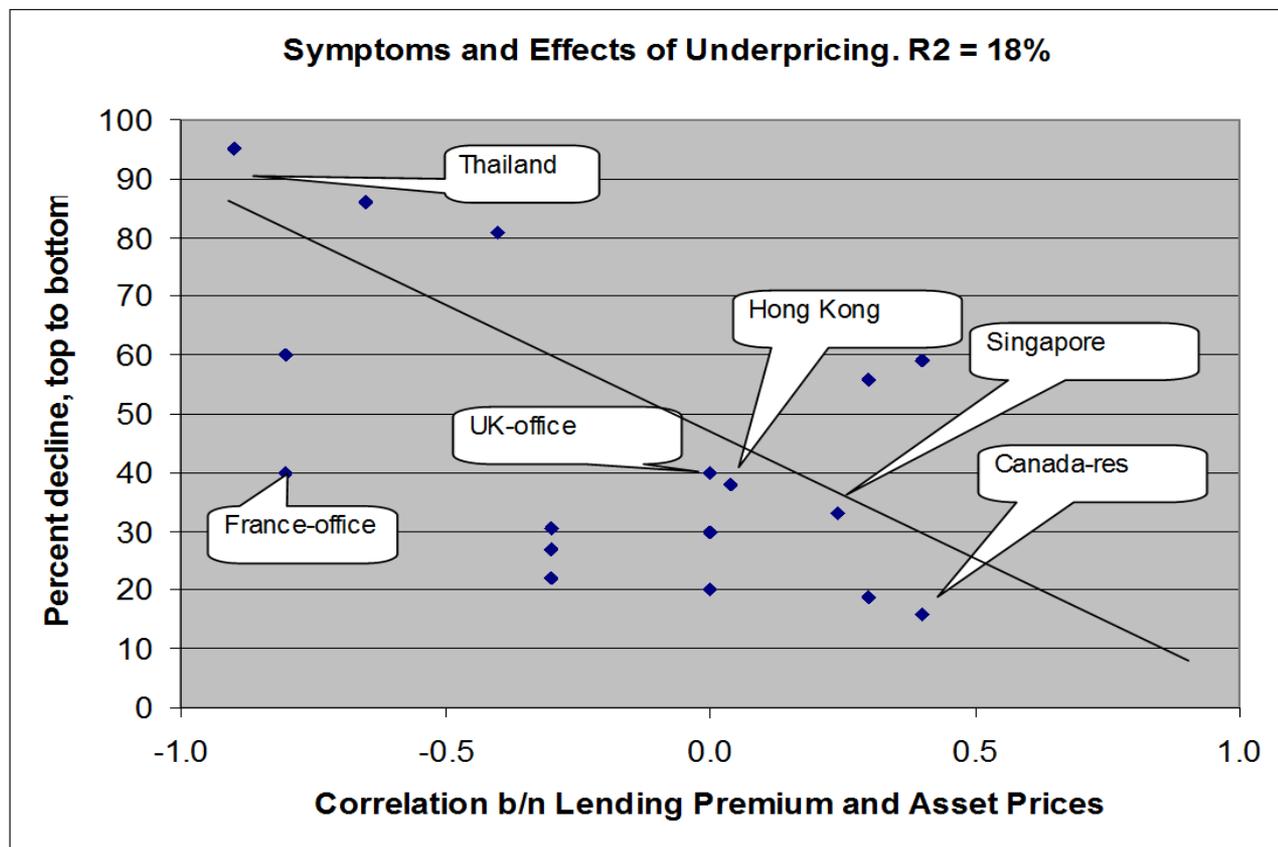
- 1990s: Japan
- 1997: Asian Financial Crisis
- 2007: Subprime Crisis US
- Simultaneous bubbles in UK, Ireland and Spain (Bank-led)

- **Credit propagates asset bubbles: systemic risk episodes result**



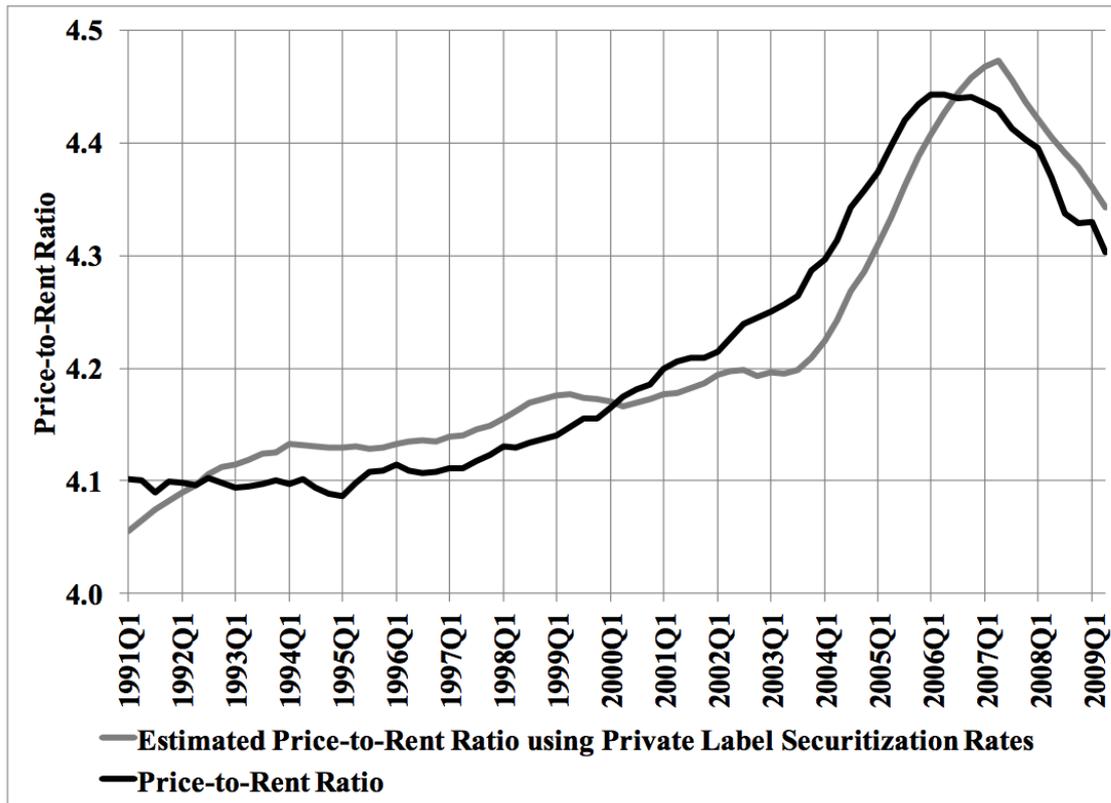
The Pavlov-Wachter Indicator of Underpricing of Risk

- **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**



Source: Pavlov and Wachter (2009) "Mortgage put options and real estate markets."

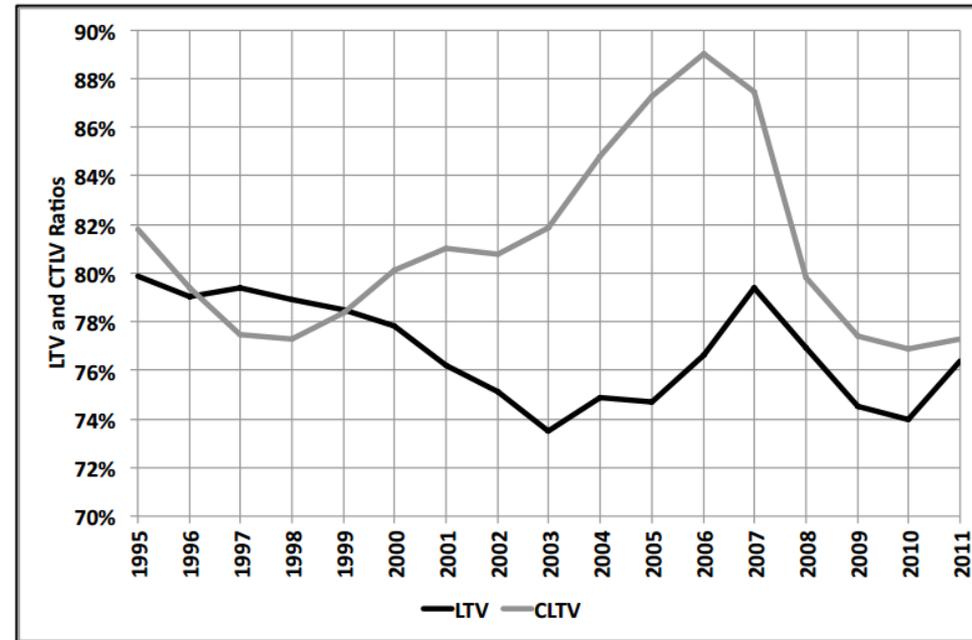
Price to Rent Ratio Estimated Using PLS Share of Overall Securitization in the US Subprime Crisis



Source: Levitin, Pavlov and Wachter (2012) "Will Private Risk-Capital Return? The Dodd-Frank Act and the Housing Market."

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



Source: Levitin and Wachter (2015) Second-Liens and the Leverage Option

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

Susan M. Wachter

Sussman Professor

Professor of Real Estate and Finance

Co-Director – Penn Institute for Urban Research

The Wharton School, University of Pennsylvania

Tel: [215-898-6355](tel:215-898-6355)

Cell: [610-299-9714](tel:610-299-9714)

wachter@wharton.upenn.edu





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KNOWLEDGE FOR ACTION
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