Housing, the Economy, and Public Policy

By Professor Chris Mayer
Today’s outline

• Housing and credit markets update
• Second liens, underwater borrowers, and mortgage delinquencies remain a problem
• Policy has been mostly lacking and ineffective
• Rental market will grow
Today…House prices appear to have stabilized, but might be temporary

- Existing home sales at 4.6 million are above the pace of the last several years (4.2-4.3 million since 2009)
- Homes on the market have been falling, but most improvements are due to a backlog of foreclosures due to legal constraints on foreclosures
- With the Attorneys General Settlement, there are likely to be at least 3-4 million new foreclosures in the next 3 years. (Some analysts estimate as many as 5-7 million foreclosures before the crisis is resolved)
Foreclosure inventory in judicial states remains at all-time highs

Judicial
(almost 50% are 2-years+ past due)

Judicial
(under 30% are 2-years+ past due)

Foreclosure % for Judicial vs. Non-Judicial States

Judicial: 6.52%
National: 4.13%
Non-Judicial: 2.43%
Mortgage credit conditions are extremely weak

- Mortgage delinquencies falling, but not as much as for credit cards or auto loans
- 95% of new mortgages are backed by the government
- Credit is not returning to mortgages as it is in other sectors of the economy
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• Is lack of credit or lack of demand responsible for slow housing market?
• How does this impact overall economy?
Housing credit performance is poor

Equifax
Select Business Lines, 30 Plus DPD (Excludes Write-Off) Dollar Delinquency Rates

First Mortgage
Auto
Bankcard
HELOC
Agency mortgage performance closer to bank and private label mortgages

Agency mortgages in Blue include FHA, VA, Fannie, and Freddie
Lending has returned for Autos, CC’s

New Bankcard Credit

New Home Equity

New Auto Finance

New Bank Auto Loans

Source: Equifax Credit Trends
Mortgage originations keep declining; 30% of home sales have no mortgage (Govt. is 95% of market)

Source: Equifax Credit Trends
Subprime Bankcard (and Auto) lending is returning (FICO<660)
Mortgages are now priced 120 bp above wholesale rates, a record level.
Little competition in mortgage origination

Market Share of 5 Largest Originators

Top 5
Mortgages are only available for the best borrowers

**Median Credit Scores**

- **Prime**
- **FHA**

**Share of Lenders Offering GSE-Eligible Loans by Credit Quality**

- **Percent**
  - 100
  - 90
  - 80
  - 70
  - 60
  - 50
  - 40
  - 30

- **2005**
- **2011**

Source: Calculations from LPS Applied Analytics data

Source: LoanSifter and Morgan Stanley Research

Note: For a hypothetical owner-occupied 30-year conventional fully documented mortgage

Source: David Greenlaw, Morgan Stanley
Commercial banks like Agency MBS instead of holding mortgages
Policy has not been very effective

- Monetary policy has little impact on current US mortgage market due to serious frictions
- Mortgage lending standards are the tightest they have been in decades
- Investors have a hard time obtaining financing to purchase homes for rental
- **Key:** Government policy coming out of a financial crisis should focus on restoring credit at normal terms (but has not!)
Many borrowers cannot refinance

Share of Agency-Backed Mortgages With LTV Above 80%

Effective Interest Rate on Outstanding Mortgages

Source: Bureau of Economic Analysis and Freddie Mac

3. Many borrowers cannot refinance.

4. Source: Bureau of Economic Analysis and Freddie Mac

5. Current 30-Year Fixed Rate for New Originations

Source: David Greenlaw, Morgan Stanley

6. Source: Morgan Stanley Research

Note: Current mortgages only
Rentership and Living at Home: The New American Dream?

Household Formations Are Running Below Trend

- Trendline: March 2001 to December 2007

Rentership and Living at Home: The New American Dream?

Rental Market Conditions Are Starting to Improve

- Effective Rent (Dollars, Right Scale)
- Occupancy (Percent, Left Scale)

Source: Census Bureau

Source: AXIOMetrics Inc.

Source: David Greenlaw, Morgan Stanley
Housing market and the economy

• Slow housing market is a key reason for the sluggish economy in the US

• Housing is tied to the economy (but the economy is tied to housing)

• My views:
  – Broken credit markets and a miss-allocation between housing supply and demand will continue to hamper housing without stronger policies
  – New construction will likely pick up, but it may be for rental housing
Auto sales have started to recover faster than housing
Housing Starts

Current as of February 2012
Source: U.S. Census Bureau
Housing Starts: National Seasonally Adjusted Annual Rate
Residential Construction
(share of GDP)

Source: Bureau of Economic Analysis
Conclusion for housing/mortgages

- Policies have had relatively little success in stabilizing US housing
- Future policies need to re-establish reasonable lending standards and reduce frictions;
- Rental market for single-family homes is growing
But housing prices did not boom or bust equally across the US
House Prices in Cyclical Markets

Source: OFHEO, Case–Shiller Index and BLS
OFHEO Index Current as of Quarter 4 2011
Case–Shiller Index Current as of January 2012
Real Home Price Index
House Prices in Cyclical Markets

Source: OFHEO, Case–Shiller Index and BLS
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House Prices in Steady Markets

Source: OFHEO, Case–Shiller Index and BLS
OFHEO Index Current as of Quarter 4 2011
Case–Shiller Index Current as of January 2012
Real Home Price Index
House Prices in Steady Markets

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OFHEO Index Current as of Quarter 4 2011
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Real Home Price Index
House Prices in “Bubble” Markets

Source: OFHEO, Case–Shiller Index and BLS
OFHEO Index Current as of Quarter 4 2011
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House Prices in “Bubble” Markets

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