Mortgage Finance:
Which Way Forward (or Backwards)

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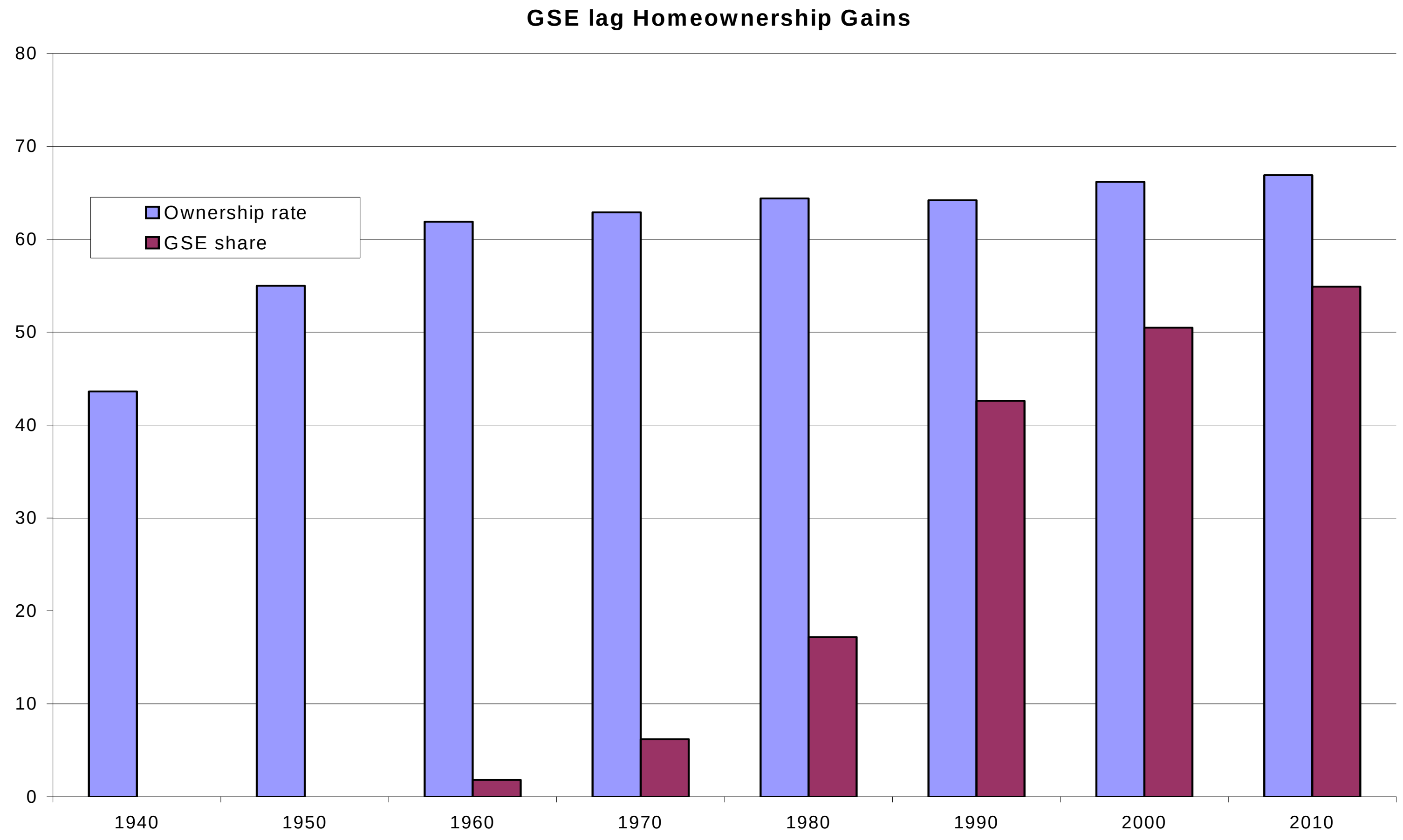
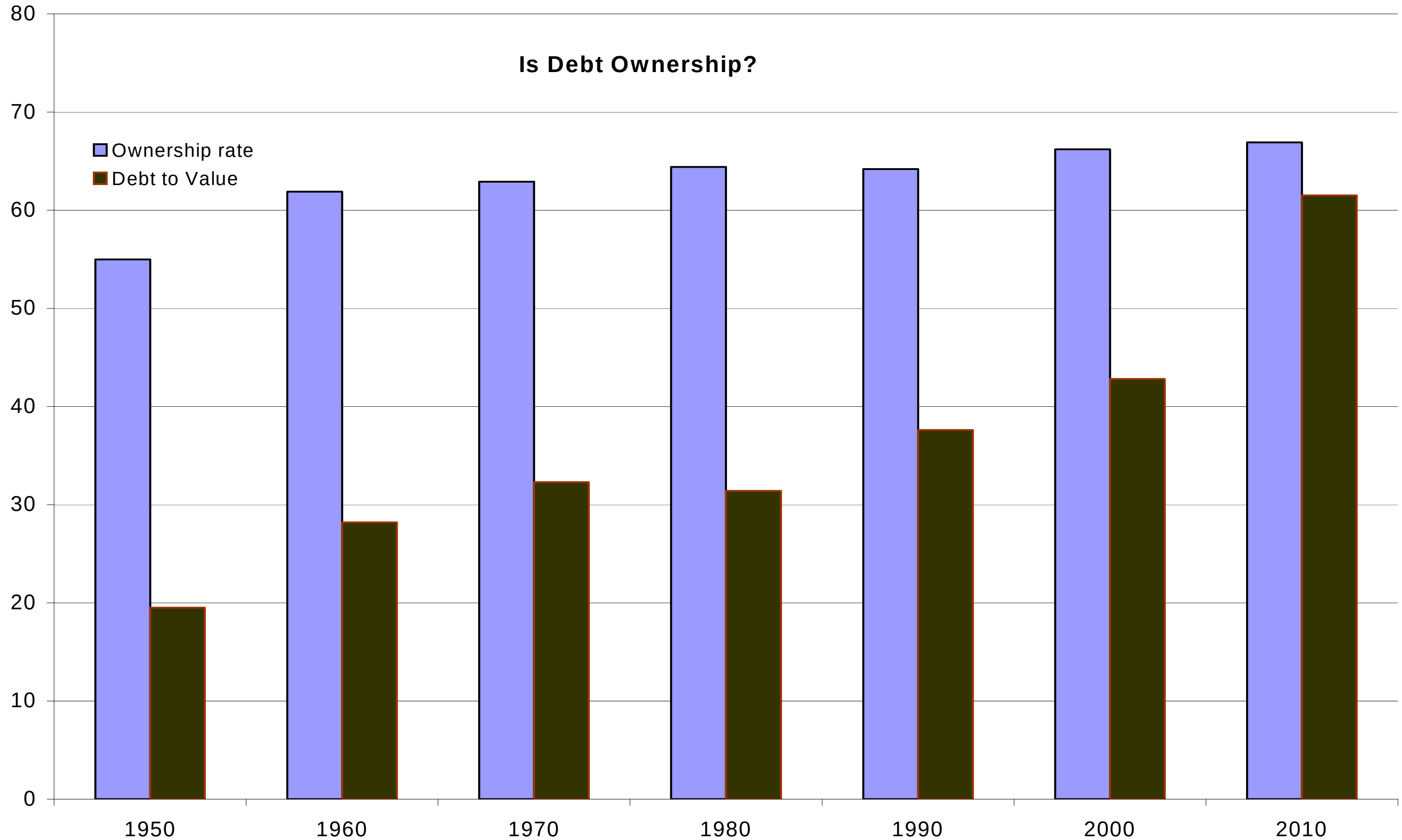
Does Homeownership Merit Subsidy?

- Homeownership correlates with lots of positive outcomes.
- Homeownership not without its costs.
- Marginal and average homeowner not the same.
- Externalities generally local in nature.
- Job, economic-impact exaggerated.
  - We all have to live somewhere.

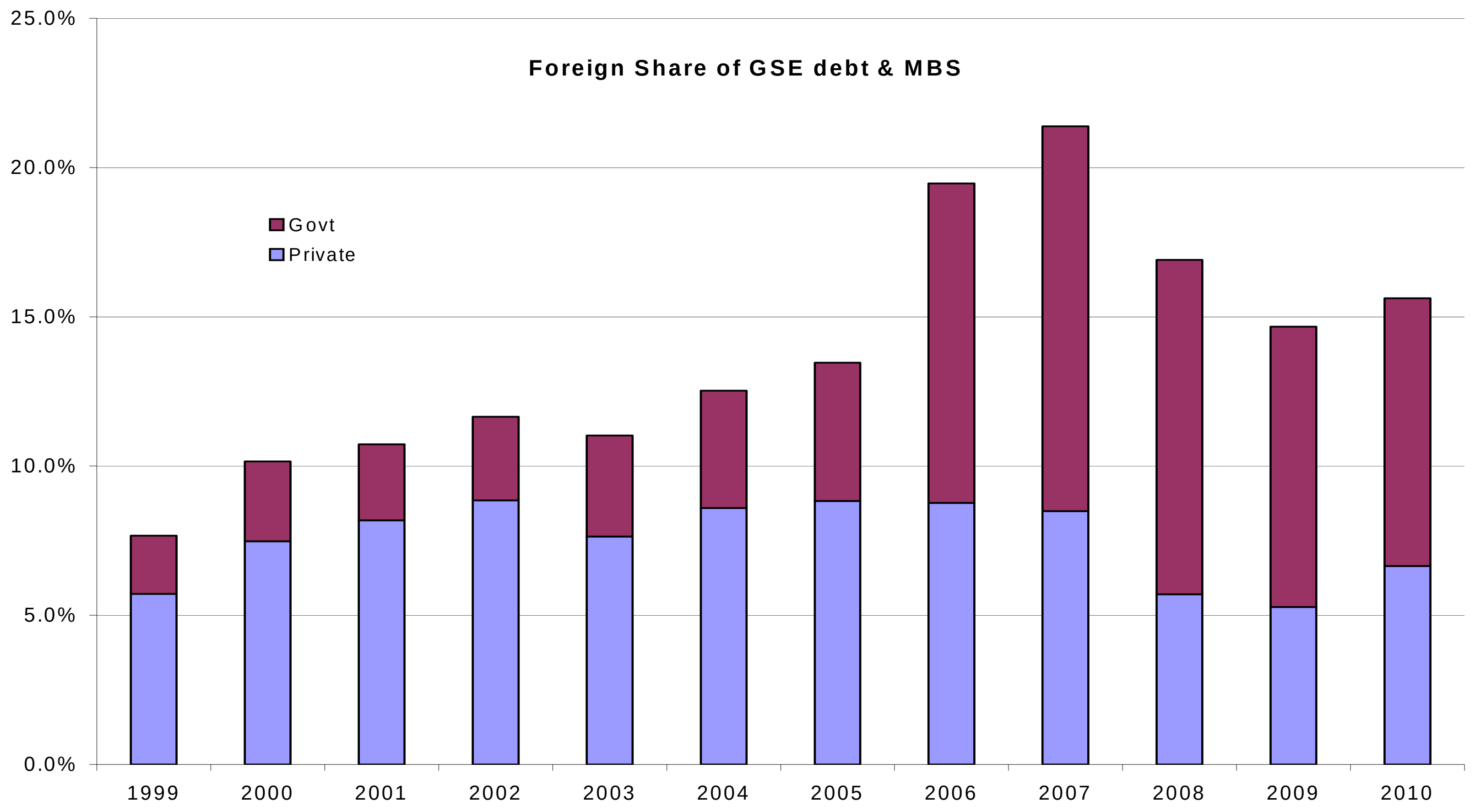
Homeownership Gains Largely Precede GSE activity



Added Leverage has not delivered long-term gains



We can fund our own mortgage market



GSEs, Liquidity and Branch Banking

- 1930s liquidity solution to fragmented banking system.
  - 1935: 14,125 banks; 3,112 branches
  - 2011: 6,291 banks; 83,209 branches
- Geographic diversification problem solved?
- Lender of Last Resort
  - Federal Reserve
  - Federal Home Loan Banks

If not GSEs, then who funds the mortgage market?

- Not a $10 trillion Q, so much as a $7 tril.
- No need for a big bang.
  – 2012 needs about $1 trillion in originations.
- Those who fund GSE can fund the mortgage instead.
  – Banks – have capital/deposits for 2012 need.
  – Pension/insurance – possible $1 trillion.
  – Mutual Funds – another $trillion.

Concentration of GSE risk in banking sector: Systemic risk, anyone?

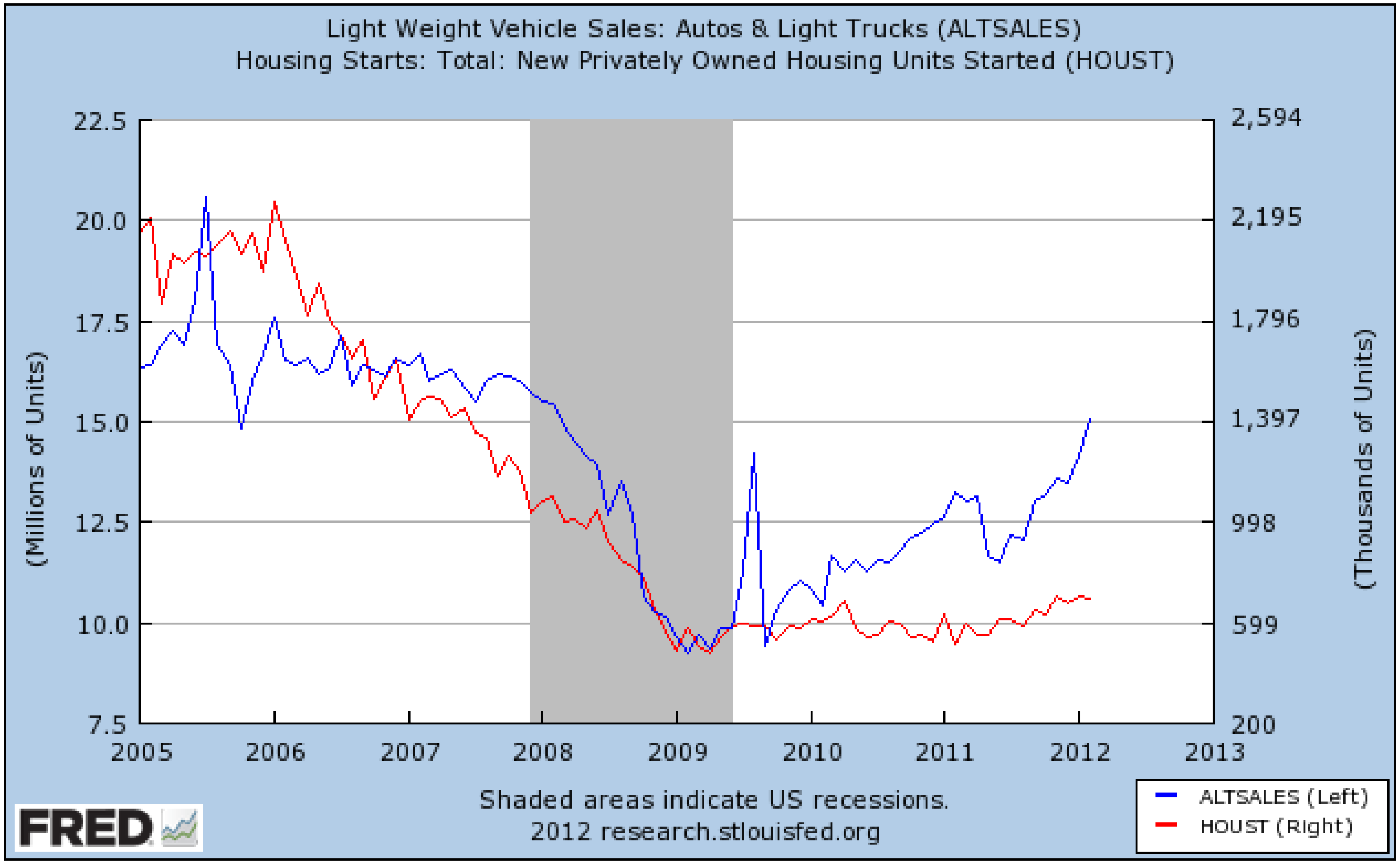
Holdings of GSE-Related Securities By FDIC-Insured Institutions as of 12/31/10			
	Securities ($ 000)	**Holdings to Tier 1 Capital (%)**	**Holdings to Total Assets (%)**
Direct Obligations	**276,751,917**	**23.8**	**2.1**
Savings Associations	33,907,579	34.7	3.6
Commercial Banks	242,844,338	22.8	2.0
MBS	**1,097,918,179**	**94.5**	**8.2**
Savings Associations	139,774,254	142.9	15.0
Commercial Banks	958,143,925	90.1	7.7
Total	**1,374,670,096**	**118.3**	**10.3**

Backwards to go forward

A deposit-based mortgage finance system

- Most of developed world is deposit-based.
- Reduce asymmetric information problems.
- Much of securitization was Basel driven.
- Improves loss mitigation, reduce foreclosures.
- Limited geographic diversity problem solved.
- Deposits “sticky”

Sectors w/o extensive guarantees performed no worse



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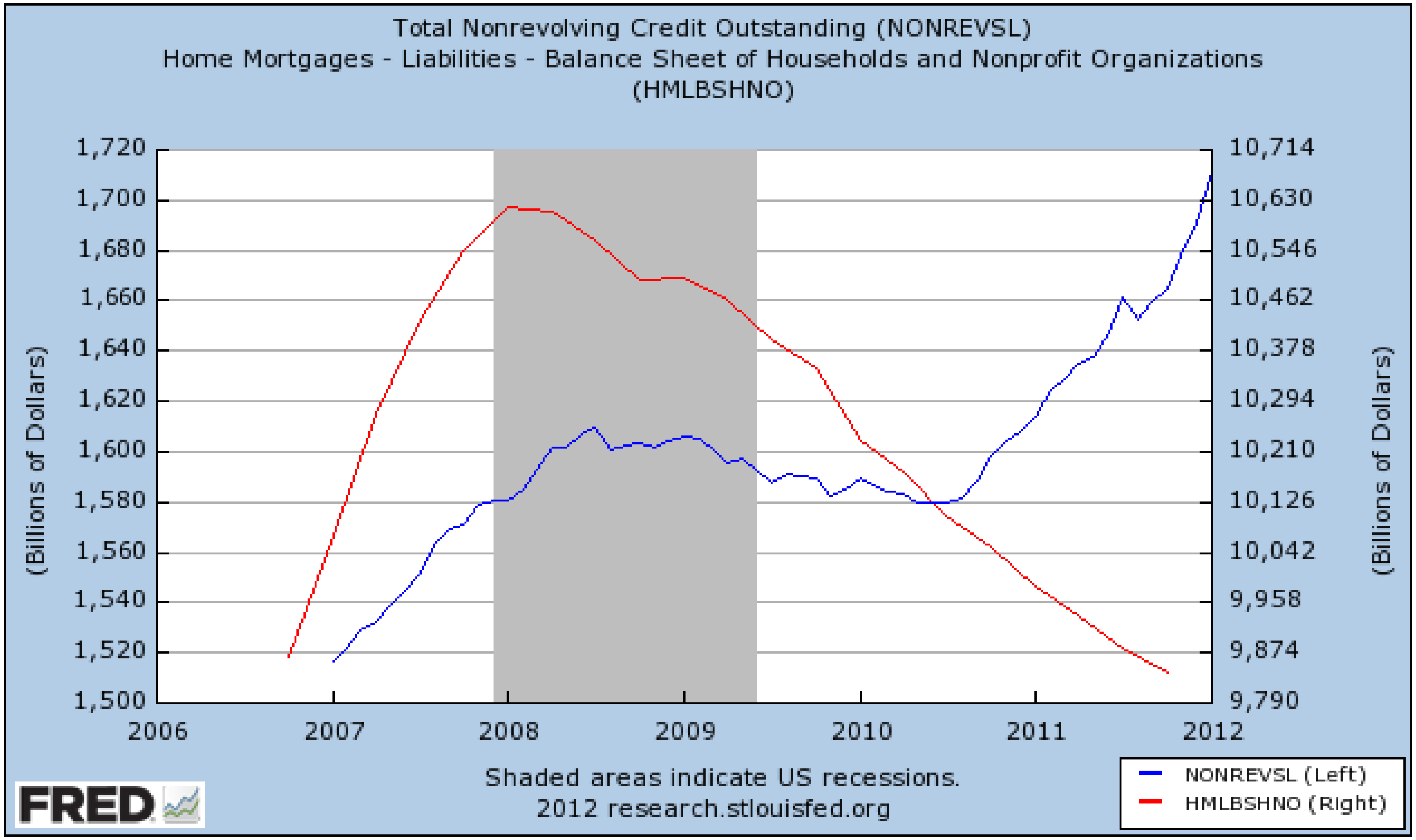


If we fund auto loans w/o guarantees….

- Affordable rates, currently around 4.7%.
- Fixed rate generally available for up to 5 years (average mortgage life = 7 years).
- While some problems, auto loan market continued even as auto-ABS channel declined.
- High Loan-To-Values.
- Easier to collect (bring back recourse).

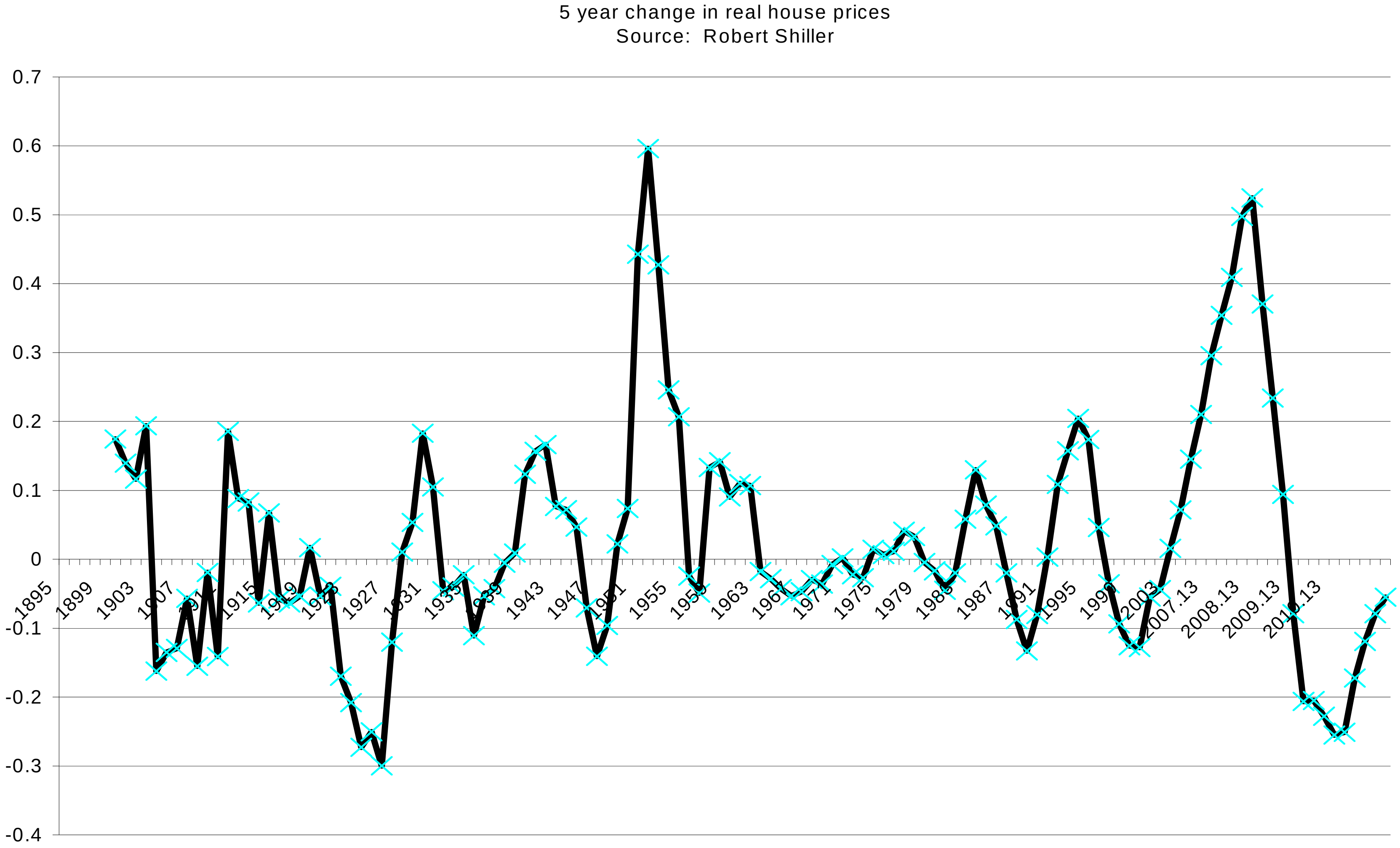
Towards A Positive Political Economy of Mortgage Finance

- Insurance Premiums **will** be under-priced.
- System will likely be pro-cyclical.
  - Democracy loves a bubble.
- Standards/Safeguards will be eroded.
- Federal insurance is cash-flow driven.
- Funding pressure make contingent liabilities more attractive.

Crisis was not “tail event”

- Competition and Guarantees don’t mix.
  - Competitive pressures insure guarantees will be called upon.
- Housing/Business Cycle not going away.
- Gov’t Regulation insufficient to control moral hazard.
  - Weak regulatory incentives.
  - Political pressures.

Safe As Houses?



Policy Principles

- No capital arbitrage – like capital for all.
- No credit allocation.
  - No special status for housing.
- Risk-bearing must be transparent.
  - No contingent liabilities.
- Finance should not be a tool for redistribution of wealth/income.
  - Transfer should be on-budget, appropriated.

Conclusions

- Already have buyer of last resort – Fed.
- Backstop as likely to create a crisis as to help resolve or avoid one.
- Mortgage Finance System only as good as your monetary policy.
- Political system as source of systemic risk.
- There are sufficient “private” funds to support the mortgage market.