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

Foreclosure % for Judicial vs. Non-Judicial States

- Judicial: 6.52%
- National: 4.13%
- Non-Judicial: 2.43%

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

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

- 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

0-30 DLQ

30-60 DLQ

60-90 DLQ

FC to REO
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

- Graph showing market share trends from 2007Q1 to 2011Q1 for the top 5 mortgage originators.
Mortgages are only available for the best borrowers

Median Credit Scores

Source: Calculations from LPS Applied Analytics data

Share of Lenders Offering GSE-Eligible Loans by Credit Quality

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%**

- **Principal Amount**
- **Number of Mortgages**

**Effective Interest Rate on Outstanding Mortgages**

- **Percent**

Source: Morgan Stanley Research
Note: Current mortgages only

Source: David Greenlaw, Morgan Stanley

Source: Bureau of Economic Analysis and Freddie Mac
Rentership and Living at Home: The New American Dream?

Household Formations Are Running Below Trend

- Trendline: March 2001 to December 2007

- Source: Census Bureau

Rental Market Conditions Are Starting to Improve

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

- 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.
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
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

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

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 “Bubble” 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 “Bubble” 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