

Housing Market Triage Conference:
An Exploration of Best Practices at the State Level for
Dealing with the Subprime Debacle
(Draft Revised November 11, 2007)

These are ideas built upon Susan's thought of a potential conference at University of Pennsylvania sponsored by Conference of State Bank Supervisors and the National Governor Association along with University of Pennsylvania Institute for Urban Research and George Washington University's Institute for Public Policy as a follow-up to the Research Roundtable on Developing a Research Agenda on the Subprime Mortgage Crisis led by John Weicher, Susan Wachter, Richard Green and Maury Seldin. It was amended after Susan suggested a workshop approach and after Norm Miller pointed out the difficulties in renegotiating securitized mortgages, which may be thought of as a holders in due course issue.

A variation of the conference idea is to have a series of workshops dealing with issues such as which mortgage borrowers are entitled to relief from some of the terms of the mortgage, what are the options for providing the relief, and what institutional changes should be made to remedy the market practices that fueled the debacle.

The subprime debacle is composed of a series of local housing market situations that make up an aggregate national problem. The danger of the greatest potential disaster is a cascading of market declines from those distressed local housing markets to other local housing markets and from housing markets to consumer spending and thence to a national recession or even depression. The great difficulty is that the probability of such a disaster is not known, but the more that is known about the risk the greater the difficulty in countering it. Thus a minimax strategic approach requires taking action to avert the cascading.

The creation of effective strategies may be a lot more complex than many people think because there are so many views of what strategy is and many of them are oversimplified. A workshop on strategy might be in the picture, or strategy might await the conference that serves as a capstone to this year's effort.

The potential sponsors of such a conference should reach a consensus of how to organize it, especially by inclusion of the various organizations representing state governors and regulators, and perhaps some selected specific state representatives that are in position to significantly impact state policy. The most critical aspect of this entire approach is getting a really good picture of the local situations such as what really happened in Maple Heights (see September 2 NY Times story and why).

The best way to get answers to such questions is through research in the local market. That is best done by selecting a series of local markets representing different situations. More is presented on this approach in the discussion of some ideas on such a conference that follows.

Since some states have already taken action in addressing the subprime crisis and are in the process of enhancing their program, and others are ready to start making choices, it will be useful to explore the best practice from what is already known, and thought to be known and to develop some additional ideas for demonstrative testing. The salient aspect of this approach is that a comprehensive strategy will be developed for the particular state in which a selected local market is researched on its subprime issue and the housing market debacle along with the undesired consequences.

Strategies will vary by state, and representatives of the state being studied will be on the team recommending the strategy, but commonalities will exist in states with high recent house price increases partially fueled by teaser rate loans and subprime mortgages. They may be areas of historic strong growth and substantial excess inventory of foreclosed homes.

At the other end of the spectrum are those states in low growth areas in which the market has been weak in recent years. However, subprime mortgages to lower income residents who are approaching interest rate and payment resets bear exceptionally high risk of foreclosure.

The series of analyses for this approach requires that mortgage loans in the local market being studied to be disaggregated to reveal sub-classifications that may involve different treatment. For example, classifications might include primary residences acquired with subprime loans, primary residences refinanced with subprime loan teaser rates, second homes, rental houses. Additionally, identification of location concentrations of the loans is of importance as is the date upon which the reset is scheduled.

Further data required includes the number of foreclosed properties available on the market, the number of homes in foreclosure, the number of mortgages in default, and the number of loans not apparently in a revealed problem.

There are two different types of problems, but related. The first relates to relief for individual borrowers on the basis of the category of their situation. For example, homeowners who finance or refinance based upon misrepresentation of the character of the loan and who will not be able to afford reset rate and payment, eventually leading to foreclosure without some intervention. At the other extreme is an owner/speculator who too took a teaser rate with knowledge of the risks but now finds the value of the home less than the mortgage. There are other categories. The workshop approach can develop the categories and make recommendations on qualification for relief. Inclusion in a relief category may vary by state depending on where in the range of liberal-conservative spectrum of values the state reps see as appropriate, or the realpolitik of the situation.

The other problem is a locational problem in which there is a potential cascading of prices because the market reaches the tipping point.

This analysis focuses on a submarket in which foreclosed homes and homes that are in high risk of foreclosure could add enough to the supply of available product that price

declines could accelerate. For the resale market, data such as average time on the market as well as price changes are important. If the area has substantial new construction, additional data are required, for example, unsold inventory and housing under construction.

The market analysis for local areas needs to forecast two closely related items. One is price trend (how much longer will the price decline continue and how low will prices go). The second deals with researching how long would it take to absorb the existing inventory, and how long to return to some specific previous price.

This information is relevant to the construction of models relative to the decision to foreclose or to renegotiate the mortgage (and to what level). On a microscopic basis it is a decision on how to play the suit rather than the hand, to use a bridge analogy. Lenders have models on how to play the suit. What they probably don't have is models that reflect aggregate analyses of other lenders making decisions. The classic London Commons example indicates the necessity for such an analysis and measures to assure appropriate action. Such measures may be discussed in the workshop that considers the options for providing the relief and/or the strategy workshop.

On the other side of the table, the borrowers have their intuitive models of what will pay for them. Sophistication varies, as does motivation. But, the playing field is not level. There may be options to provide borrowers with better information.

The really tough question is when would a tipping point be reached. Experience with racial integration in neighborhoods may be useful. But, some educated guessing may be necessary in order to safely avert a cascading of default.

The Hoyt website, <http://www.hoyt.org/subprime/index.html> contains more information.