Housing Stability, Systemic Risk and Securitization

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HOUSING, STABILITY AND THE MACROECONOMY: INTERNATIONAL PERSPECTIVES

HOUSING STABILITY, SYSTEMIC RISK AND SECURITIZATION

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Housing Stability, Systemic Risk and Securitization

• International House Price Boom-Bust of 2003-2008
• Good or Bad Securitization
• Implication of the Banking/Financial System
  – Real Estate Booms and Banking Busts
  – Fundamental Problem of Incomplete Markets and Mispriced Risk
  – Banks as Secret Keepers v. Transparency
• Securitization as a Solution?
House Price Boom and Bust in the US
International Headlines 2007-2009

September 18, 2007

Darling steps in to halt bank run

December 22, 2008

Ireland Props Up Three Banks and Takes Control of One

UK and Iceland clash on crisis

March 30, 2009

El Banco de España interviene por fin la CCM tras dos meses de dudas
Global Housing Prices Peak in 2007

Sources: BIS; Bundesbank; FHFA; Japan Real Estate Institute; NVM; Nationwide; OECD; Office for National Statistics; Standard & Poor’s; Statistics Denmark; Statistics Netherlands; Statistics Sweden; Thomson Reuters; vdpResearch
Prices Rise as Interest Rates Decline from 1990-2004

Aggregate values include data from: Spain, Ireland, U.K., Netherlands, Belgium, U.S., Japan, France, Canada, Italy, Australia, Sweden, Germany
Interest Rates Bottom in 2003
Mortgage Debt to GDP Ratio Grows at 4.8% per Year from 2000-7 and at 4.6% from 2004-7 for the EU27

Residential Mortgage Debt to GDP Ratio, %

- Netherlands
- Denmark
- UK
- Ireland
- Sweden
- Spain
- Portugal
- EU27
- Germany
- Luxembourg
- Belgium
- France
- Estonia
- Latvia
- Greece
- Italy

2007
2000

0 20 40 60 80 100 120

2007
2000
Securitization Takes Off 2003-2008

Figure 2.4. European Private-Label Securitization Issuance by Type
(In billions of U.S. dollars)

Figure 2.9. Global Covered Bond Issuance
(In billions of euros)

Sources: IMF staff estimates based on data from European Securitization Forum; JPMorgan Chase & Co.; and Moody’s.
Note: ABCP = asset-backed commercial paper; ABS = asset-backed security; CDO = collateralized debt obligation; CDO^2 = CDOs backed by CDO, ABS, and MBS; MBS = mortgage-backed security. Data for 2000 through end-June. For ABCP, 2000 data through end-May. ABCP data represent period-end outstanding.

Sources: European Covered Bond Council; European Securitization Forum; Barclays Capital; Société Générale; and Dealogic.
Mortgage debt to GDP rise results in systemic risk

Market Share of Nontraditional Mortgage Products and Private Label Securitization


MBS Issuance: Subprime and alt-A at 0 by 2008

Rates Out of Line with Projected Losses

- Expected annual loss for subprime and alt-A jumps in 2005
- But not the required rate of return, using data available at the time
- Despite unpriced increased risk, mortgage flows increase in 2006
- Prices rise 24% from 2004 to 2006, 8% from 2005 to 2006
- Price volatility resulting from excessive mortgage supply/NTMs
Fundamental Problem: Real Estate Booms Put Financial Intermediaries at Risk

- With heterogeneous beliefs and lack of short selling, optimists set prices.
- Lending at collateral’s market price set by optimists implicates banking/financial system.
- Banks may reduce lending standards in feedback loop.
- Price expectation formation, misaligned incentives, moral hazard issues
Fundamental Factors

Demand for Real Estate

Price of Real Estate

Supply of Credit

Banks
- Value of Real Estate Assets Owned
- Value of Loans Collateralized by Real Estate
- Assessment of Risk of Real Estate Lending

Supervision & Regulation

Drives Real Estate Prices
Calls for Transparency in Securitization Markets

- Securitization, the major innovation did not prevent market collapses, e.g. Spain.
- Information infrastructure, enhanced capital requirements
- Securitization markets for price discovery with full information and risk pricing
Transparency in Securitization Markets: Not a Panacea

- Securitization with full transparency with herding behavior, contagion effects, and imperfect information is reintroduces instability.

- Liquidity, risk pooling issues: Opacity maintains the pool.

- Price Revelation Securitization: Derivative markets with for price discovery with full information and risk pricing can provide signal risk, raise cost of capital, and complete markets.
Thank you

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