

# Implications of the Housing Market Bubble for Sustainable Homeownership

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The views expressed do not represent those of the Federal Reserve Board  
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# Overview

- Housing and mortgage market data from the “bubble” and “crisis” period suggest impacts to sustainable homeownership
- There are feedback effects between expansion of high risk lending and rising house prices
- What caused the excessive expansion of mortgage credit?
- How might policymakers mitigate recurrence of these problems and promote sustainable homeownership?

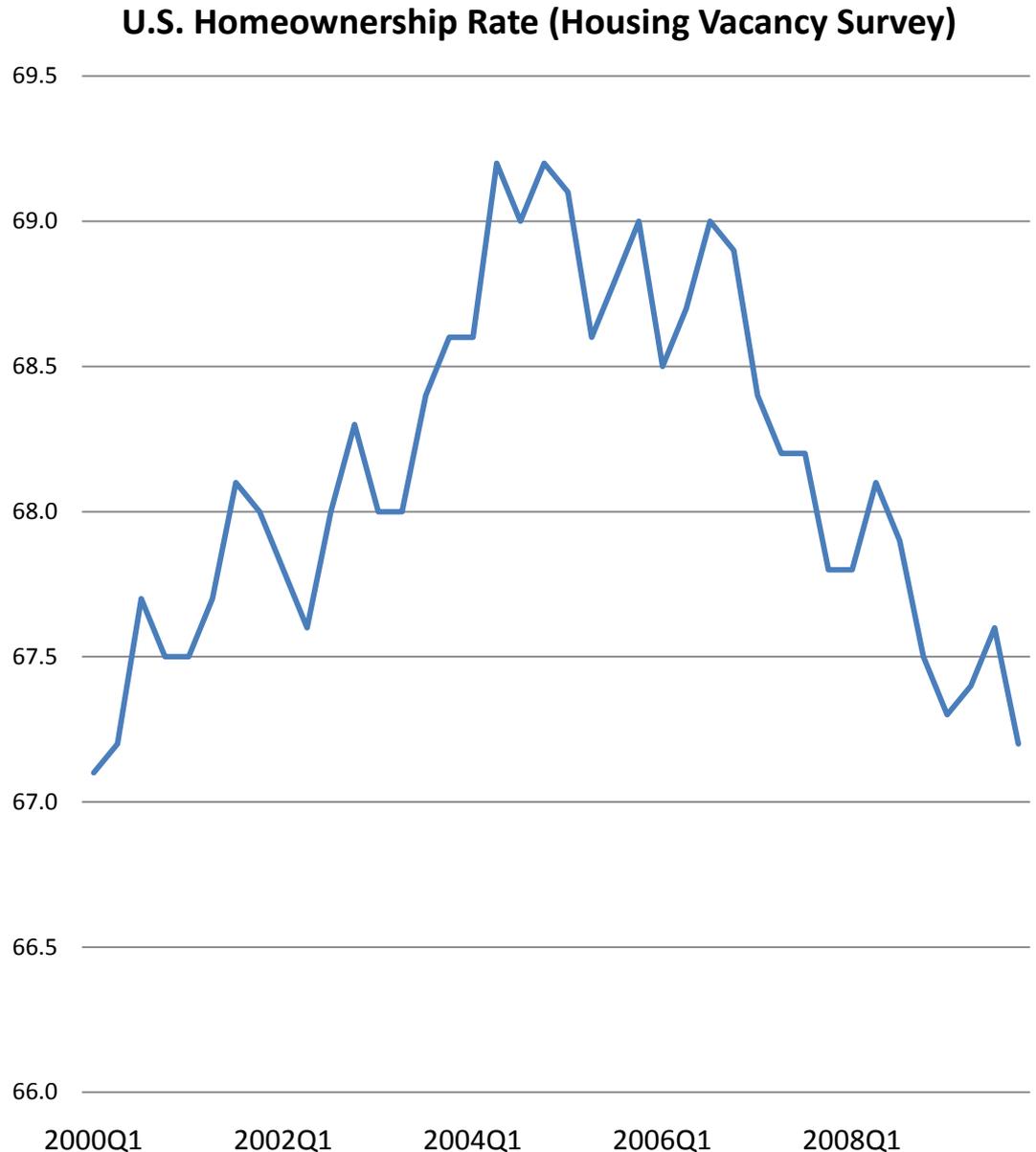
# Homeownership rates peaked prior to the housing “bubble”

The bubble and subsequent meltdown dealt a triple blow to sustainable homeownership:

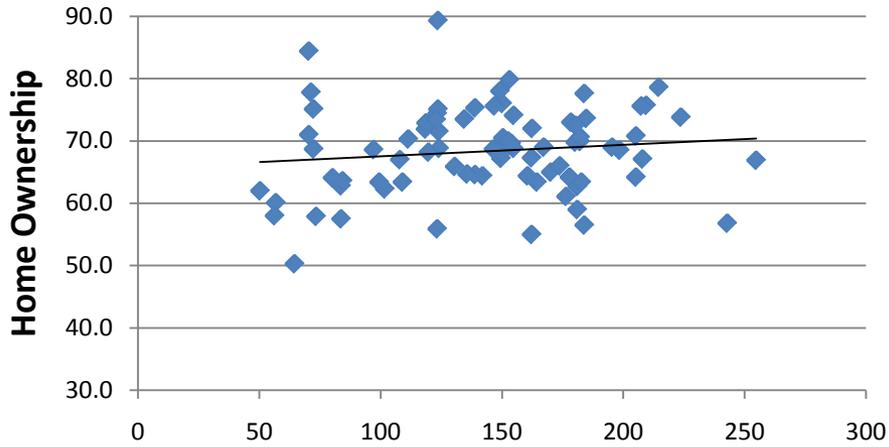
(1) Reduced affordability because of rapidly rising home prices

(2) Expansion of high risk lending and subsequent foreclosure crisis

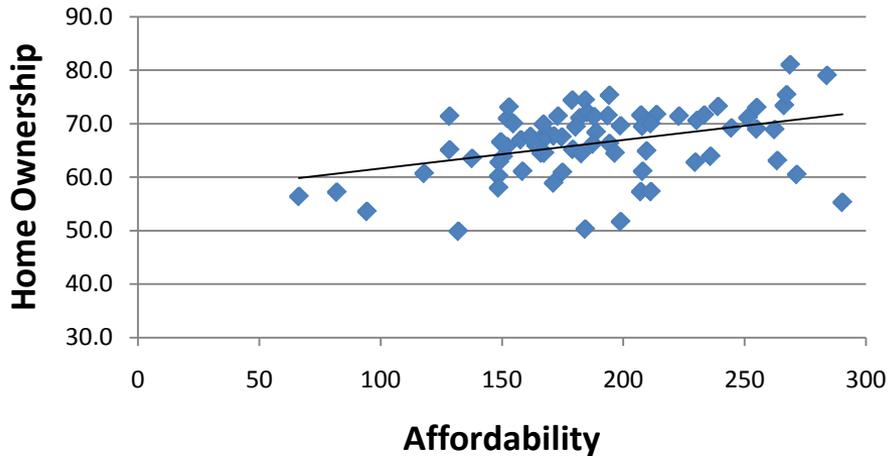
(3) Reduced household creditworthiness and procyclical supply response (credit tightening, secondary market contraction)



**2005Q1**



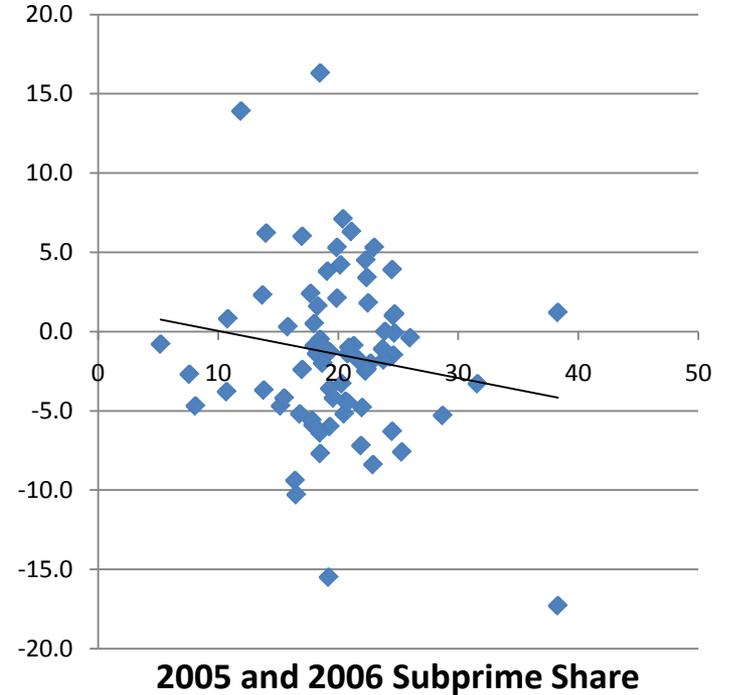
**2009Q4**



**Affordability and Homeownership**

Lower affordability is associated with a lower homeownership rate across large U.S. metropolitan areas. Post-crisis, this relationship is much stronger. [Correlations .12 and .39]

**2005-2009 Change in Homeowner ship Rate**



**High Risk Lending and Homeownership**

There are feed back effects between high risk lending and rising house prices. Larger share of high cost loans during 2005-2006 is associated with a larger drop in homeownership between 2005 and 2009. [correlation=-0.15]

# What Caused the Overextension of Mortgage Credit?

- Moral Hazard and Incentive Problems
  - mortgage brokers
  - rating agencies
  - weakened risk controls
  - appraisal biases
- Incomplete Risk Transfer
  - Systemic part of risk not transferred
- Structured Finance / Counterparty Risk
  - Systemic risk in highly rated securities came to be underpriced
  - These instruments were earning profits although fundamentally loss-making
  - Complicated interrelationships made tracking of counterparty risks difficult
- Regulatory limitations
  - Lack of information on where risk resides; inadequate accounting of potential systemic risks

# Policy Responses

- Strengthening consumer protections
- Increased focus on misaligned incentives
- Increased capital requirements
  - Need for caution (procyclicality issue, “endogeneity” of economic capital)
- Improved financial and regulatory data
  - Regulators need better access to data organized to ferret out weaknesses in the financial system as they develop

# Micro-Macro Financial Database

- The Flow of Funds is a reasonable conceptual framework for comprehending systemic risk
- Provide more detail to US Flow of Funds ?
- Use microdata sets to measure covariance risk of instruments ?
- Link aggregated data to microdata to enable drilling down and aggregating up across a variety of aggregates?
- Link microdata across datasets with standard identifiers?
- Record guarantees/repos/derivatives?
- International cooperation?
- Allow economic researchers access?