

***Comments on Sustainability***  
Federal Reserve Bank of Philadelphia:  
Rethink. Recover. Rebuild: Reinventing  
Older Communities

Marsha J. Courchane

May 12, 2010

**CRA** Charles River  
Associates

# Sustainability

---

## I. Calem/Nakamura/Wachter: Implications of the Housing Bubble

- **Bubble Impacts**
  - Rising house prices reduced affordability
  - Reduced affordability led (?) to higher risk lending
  - Consumer protections
  - Issues with pro-cyclicality

## II. Gerardi/Foote/Willen: Can We Predict a Bubble?

- **Prediction of Bubbles**
  - No ex-ante consensus
  - Need realistic expectations about abilities of regulators
  - Policy – require that LTV be less than 100%

## Comments

- **Costs Shared by All**
  - Require ex-ante sharing of responsibility
  - Need to understand interactions of complex layers of risk
  - Need to understand repayment capacity (what is affordable/sustainable)?

# Comments: Implications of the Housing Bubble

---

- Lower affordability is associated with a lower homeownership rate across large U.S. metropolitan areas – authors show increased correlation in post-crisis period
  - What are normative implications? Was part of the crisis not due to trying to find innovative (albeit higher risk) ways to make homeownership more affordable?
  - Can policy tools be used to craft solutions that are sustainable as a first priority?
    - Tradeoffs between affordability and sustainability? Over the life cycle?
    - Even before current crisis, large amounts of indebtedness and use of home equity for paying credit card debt – may also not have been sustainable
    - How can consumer expectations be managed toward sustainability?
  - Rising house prices
    - Linked to lowered affordability of housing
    - Also linked to increased home equity to be used for increased consumption
    - Tradeoffs must be recognized by both lenders and borrowers

# Comments: Can We Predict a Bubble?

---

- Authors argue that we cannot predict the bubble or the bursting of the bubble in real time
- Argument that costs might be lowered by requiring higher equity sharing by borrowers
  - But interesting that neither consumer side nor bankers seemed to favor higher down payments for FHA – Why not?
- Public policy goals seem to still focus on homeownership – maybe sustainable homeownership, but homeownership
  - No one wants to tell consumers how best to manage savings/assets/spending – market forces will force outcomes; but we all face the costs of those outcomes
  - No one seemingly wants to push rental housing rather than homeownership
    - Canadian model (requiring higher down payments) also focuses on all forms of shelter – not just housing

# Policy Solutions: Implicit or Explicit

---

- Reduction in higher risk lending
  - Lower LTV loans
    - Higher down payments
    - Movement away from home equity lending (change in tax treatment?)
  - Full doc loans – hard to ensure payments are sustainable/affordable without knowing value of income/assets
- Systemic risk regulator
  - Unlikely to be able to time the bubble's peak/burst – but might be able to offer suggested countercyclical tools?
  - Restrictions on total leverage?
    - Mortgage U/W sees debt at time of application – but does not track it over time
      - Possible ex post monitoring?
      - Possibly stronger U/W needed on other types of debt that may payment affordability less likely over time (e.g. credit cards?)

# Policy Solutions: Implicit or Explicit

---

- Counterparty Risk/Risk Transfer
  - Can these risks be better measured at time of transfer and over time?
  - Requirement that lenders retain risk (no possibility of full transfer of risk?)
  - Requirement that borrowers share in loss? (no loss of borrower equity if default on 100% LTV loans)
- Increased Cushions
  - House prices will decline (some day)
  - Borrowers need to have equity to withstand this
  - Lenders need to have capital to withstand this



We still have no easy answers.....but sharing in benefits as house prices rise likely mean we need to balance the sharing of costs as house prices fall