The Housing Market Going Forward: Lessons from the Recent Crisis

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What Caused the Housing Crash?

Supply > Demand

(Inelastic supply of houses versus unsustainable demand.)
New Home Construction Spurred by Unsustainable Demand Leads to Oversupply

The graph details a trend over the years from 1990 through 2011, showing the number of new homes constructed and for sale, in thousands. The X-axis represents the year, ranging from 1990 to the middle of 2011, while the Y-axis on the left shows the annualized value of the monthly number of new homes constructed and for sale, in thousands. The value started around 360,000 in 1990, fell to around 260,000 in 1993, and then rose back to around 375,000 in 1996. Monthly new home sales fell to around 280,000 in 1997, and slowly rose to about 350,000 in 2003. From 2003 to 2006, the monthly annualized value of new home sales rose to over 570,000. The value then precipitously fell from this peak to a low of just around 170,000 in 2011.

Matching this chart on the right side Y-axis is the estimated number of months of housing supply. The months of excess supply rose from about 7 to more than 9 going from 1990 into 1991. The supply then fell to less than 4 in 1994 and rose to above 7 in 1994. While new home construction fell from 1996 to 1997 and only slowly rises through 2003, the excess housing supply stayed around 4 months from 1997 through 2005. While new construction rises substantially from 2003 to 2006, excess housing supply experiences a significant increase from 4 months in 2005 to a peak of around 12 months in 2008. The decline in new home construction for sale that begins in 2006 is followed by a significant down in excess home supply of 12 month in 2008 to just 6 months in the middle of 2011.

No source is given for the data on this graph.
Housing Starts Per Capita

The slide details a graph with 3 lines. On the X-axis is the year, ranging from 1998 to 2007. On the Y-axis is the variable “housing starts per capita, in percent.” One line has data for California, Arizona, Nevada, and Florida. Call these the Sand States. A second line has data for Michigan, Indiana, and Ohio. Call these the Rust Belt States. The third line represents All Other States. The Rust Belt States and All Other States lines are very similar from 1998 to the middle of 2003. Both lines fluctuate between 0.004 and 0.005 percent. The Sand States line starts off a bit higher than the other two but by the middle of 2003 is up to 0.007 percent on its way to a peak of 0.008 in the middle of 2005. While the value for the Rust Belt States hits its peak of just under 0.005 in the middle of 2003, it starts a slow slide back to 0.004 in the middle of 2005 and then falls much faster for the next year and a half to about 0.0025 at the start of 2007. From its peak of 0.008 in the middle of 2005, the Sand States line falls to 0.004 at the start of 2007. This is just below the All Other States line which, after a small bump up from 2003 through 2006, finishes up in the beginning of 2007 right where it started in 1998.

The data are attributed to New York Federal Reserve and Economy.com.

US Residential Mortgage Debt Outstanding
Time intervals for $2 trillion increases

The slide includes a chart that graphs US Residential Mortgage Debt Outstanding, in trillions of dollars, from 1980 through 2011. The graph records about $1 trillion in US Residential Mortgage Debt Outstanding in 1980 rising – in a gently, upward-sloping curve – to nearly $11 trillion in 2008 and then falling to about $10.5 trillion in 2011. The following provides various approximate values from the graph, detailing how long it was between increases of $2 Trillion if Outstanding Debt. It took 10 years for the values to increase from $2 Trillion to $4 Trillion (about 1988 to 1998). It then took 4 years for an increase from $4 Trillion to $6 Trillion (to 2002). The next increase, to $8 Trillion took 3 years (to 2005), and the next increase, to $10 Trillion, took 2 years (to 2007). The data are attributed to the Federal Reserve Flow of Funds.

Source: Federal Reserve Flow of Funds
Factors That Led to Unsustainable Demand

1. Weak credit criteria, including expansion of low initial payment mortgages and stated income loans, all encouraged by CRA and Fannie & Freddie.
2. Speculation, fueled by fraudulent income and occupancy claims.
3. Rapid home price increases brought more young people into the market.
4. In several areas the surge in building led to a demand for more houses, that is, people buying houses based on their income from building houses.
Market Failures

1. Inadequate, backwards looking credit models with no accounting for the concentration of particular loan types, local macroeconomic factors or over-heated growth. This was the real failure of Fannie and Freddie and the ratings agencies.

2. Inability or unwillingness to detect fraud by borrowers, brokers, loan officers, and appraisers, and willful ignorance on the part of securitizers and investors. Lack of adequate due diligence.

3. Investor over-reliance on rating agencies, ignoring the fundamental differences between asset-backed securities ratings and company debt ratings.
Homeownership Rates and Trends by Age Groups

2010-15 projected population change, by age

Thousands

Ownership rates by age of householder

Source: MBA and Census Bureau
State Differences in Mortgage Performance

Is the problem primarily credit models or local economic factors?

Foreclosure Starts Rates:

<table>
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<tr>
<th></th>
<th>California 2005 Q4</th>
<th>California Peak</th>
<th>California Δ%</th>
<th>Texas 2005 Q4</th>
<th>Texas Peak</th>
<th>Texas Δ%</th>
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<tr>
<td>Prime Fixed</td>
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<td>1.07</td>
<td>26%</td>
</tr>
</tbody>
</table>

Source: MBA National Delinquency Survey