

Property Markets And Financial Turmoil

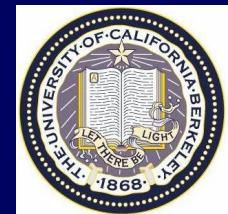
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The Transformation Of Mortgage Markets

- *Historical Practices*
 - Local Institutions
 - Assembling Local Savings
 - Lending To Local Depositors
 - Information Difficulties

The Transformation Of Mortgage Markets The 1990's

- *Specialization*

- Origination
- Investment
- Servicing

- *Securitization*

- Packaging
- Specialization
- Liquidity

- *Technical Change*

- Underwriting And Risk Assessment
- Laptop Models And Data
- Sophisticated Behavioral Models

Implications For The Economy

Division Of Labor And Separation Of Function

- Mortgage Originators
- Lenders
- Securitizers
- Credit Raters

Benefits Of Secondary Markets

- Matching By Location
- Diversifying Risk
- Stability

More Complete Markets For Investors With Different Risk Preferences

- “Slices” Of Mortgages

“Subprime lending” or “alternative mortgages” are natural outgrowth of technical change, specialization, and search for more complete markets

“risk-based” pricing vs. “rules of thumb”

Antiquated Incentives: All Transactions-Oriented, not Performance-Oriented

Broker paid	0.5 - 3.0 %	at origination
Lender paid	0.5 - 2.0 %	at sale
Bond Issuer paid	0.2 - 1.5 %	at issue
Rating Agency paid		paid by bond issuer

Nothing related to the performance of the loan

Most Important Reform: Incentives

Provide Better Incentives

A. Mortgage Broker

Bonded Or “Licensed”

“Suitability Standard”

B. Lender

Responsible For Mortgages Purchased

C. Rating Agency

Paid in Shares Of Security

D. Fewer Options?

Key Lessons?

- *Innovation In Real Estate Lending*
- *More Flexible Lending*
 - Important Benefits
 - Beware Of Moral Hazard
 - Align Financial Incentives
- *Manageable Options: Contract Design*
- *Can Be Quite Beneficial: Long Term*
- *Currently Extreme Consequences For Households And Financial Markets*
- *Linkage between Real Estate & Financial Markets*