Chapter 3: The Research Roundtable

The Homer Hoyt Institute is a unique organization. It operates with an exceptionally small staff, yet it has an astounding network of academicians and industry counterparts. Thus, when the decision was reached to support a research roundtable, it reached out to its network.

The result was the recruitment of Dr. Susan Wachter (Co-Director of University of Pennsylvania's Institute for Urban Research) and Dr. John Weicher (Director of Hudson Institute's Center for Housing and Financial Markets) to Co-chair the Research Roundtable. Dr. Wachter was an Assistant Secretary for Policy Development and Research at HUD under a Democratic administration and Dr. Weicher was an Assistant Secretary for Policy Development and Research at HUD under a Republican administration. The balance in perspectives of the leadership was an important consideration, especially because HHI is not a political partisan, does not engage in lobbying; rather, HHI focuses on facilitating research that improves the quality of real estate related decisions.

Enlisting the Leadership

While there were some phone calls, the vast majority of communications were by email. That makes it easy to tell the story by linking a series of cuts and pastes. Sometimes quote marks, dates, and addressees are not used so that the story will be more readable, but sometimes some or all of those items are included. Here is as start that provides the flavor of how things got done:

Date: Thursday, September 6, 2007 10:37 AM
From: Ronald Racster
To: Maury Seldin
Subject: Re: Research Round Table

Hi Maury.

Susan's reply is attached. Her suggestion to wait until we hear from John is a good one. I am encouraged that she did not say that October was too soon to organize a roundtable. - Ron

Wachter, Susan wrote:

I will send it--if others agree I would be pleased to be a co-chair--I think that I might be able to encourage Richard, but it would be good to have a chat with you and Richard together to understand the parameters better. Also it would be great to have John involved and I would be pleased to have John and Richard co-chair or simply one or the other.

Perhaps we should wait until we hear from John of his interest before deciding next steps. I will leave that to you. Please feel free to use my interest however to forward the process.

Regards, s

>Susan M. Wachter
>Richard B. Worley Professor of Financial Management
>Professor of Real Estate and Finance
>Co-Director - Institute for Urban Research
>Director - Wharton GeoSpatial Initiative
>The Wharton School, University of Pennsylvania

-----Original Message-----
>From: Ronald Racster
>Sent: Wednesday, September 05, 2007 5:10 PM
>To: Wachter, Susan
>Subject: Research Round Table
>Hi Susan!
> Attached is an e-mail to Richard Green.[1] Maury is waiting to hear from John Weicher about chairing an October research roundtable on subprime mortgage issues. As you see, I am attempting to interest Richard if John cannot accept. And obviously, I am enlisting you to help with Richard (sorry about that). Anything you can do would be most appreciated. We have heard nothing from Richard [he was out of the country] about his interest in working with HHI except as chair of the May Weimer School session. I am appending the e-mail to Richard which also has Maury's latest e-mail to Weicher…

Also, Maury wondered if you would send your Jackson Hole paper to Brent Smith?

Many Thanks,
-Ron

Attachments: E-Mail to Green
E-Mail to Weicher

Hi John,

Welcome back. I trust all went well with last week…

HHI has decided to move ahead with a research roundtable sometime during the first two weeks of October. That timing is important not only because of the urgency of the financial crisis and the onslaught of the impact on the housing market, but because the HHI Board of Directors meeting is on October 26, at which time the budget allocation for the project for this year will be approved. We hope to have others join in as funders as a

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[1] Hi Richard!

Word has reached me that the Weimer School Faculty has enthusiastically approved the change in topic for the May session and that you are in accord. There should be several solid papers on aspects of the topic. One session may not be enough!

I am appending correspondence from Maury to John Weicher. You will see that Maury is encouraging John to take lead role in a research round table to be held in October in Washington. While John, like Susan, has expressed interest in working on the topic, he may be unable to chair a round table.

We want you involved. I believe that you would be an equal to John as chair of the round table. We want you to be part of this undertaking, if not as chair, as a participant. I am sending a copy of this e-mail to Susan and am encouraging her to talk with you concerning any issues that you may have. I would anticipate that Susan will be of help in securing participants for a round table, as will John. Typically our research round tables have a dozen or so participants, including academic, government, and real estate professionals, five - six or so are researchers, five - six are potential research sponsors, and two - three are representatives from the round table sponsors. This round table may be somewhat larger, with the representatives from government agencies, FNMA, Freddie Mac, etc. It is a working group that focuses on generating fundable research projects. This round table will have the benefit of a literature search by Brent Smith that surveys work done on the issue.

Richard, please let me know as soon as possible of your interest in being involved.
- Ron
racster@hoyt.org
Attachment: Memo from Maury Seldin to John Weicher, dated September 5, 2007

result of the research roundtable at which guidance for the selection of supportable projects will be received. Projects will be able to start as early as November 1. There will probably be some time at the January Session of the Weimer School to get some academic discussion, but the May Session topic has been changed to feature the issues. Richard Green is heading that up.

We would like to designate the leader of the project before the end of this week, and I have been hoping to hear from you that you would fill that role. I think the back-up choice is Richard Green, but we expect that he would be part of it irrespective of whether or not you take the lead. He wrote the Jackson Hole paper for the Fed with Susan who has already indicated that she would be pleased to work on the project with you in the lead…

Maury

Hi Susan and John,

The willingness of both of you to co-chair the research roundtable is of great comfort to me. Yes, Susan, John phoned me this afternoon having returned to his office today and agreed to co-chair with you.

This project is of considerable significance in my view of repairing the world, in this case by improving real estate decisions. I note that in Susan's reply that she saw getting an agreement on parameters is the first step after identifying who are the co-chairs.

Naturally, how you work it out amongst yourselves is up to the two or three of you, assuming that you include Richard Green as the third. As both of you know, he is chairing the May Session of the Weimer School which I expect will contain some reports resulting from research sponsored as a result of the forthcoming roundtable, and that would be a nice tie-in since it is the Homer Hoyt Institute [rather than the Maury Seldin Advanced Studies Institute] that is providing the funding for the research roundtable.

Since you may have some questions about parameters as related to the Homer Hoyt Institute, I want both of you to know that HHI has a great deal of flexibility as to the development of the roundtable and will make its major commitment for research support at the HHI board meeting on October 26. The preliminary commitment is to fund the research roundtable, alone if it works out that way; but, HHI will welcome co-sponsors who want to participate in funding, starting with the research roundtable and/or with support for the research that will flow out of it…

The product we are hoping for at the end of the research roundtable is a research agenda of critical issues necessary to aid in decision making by public and private policy makers. It is notable that each of you, at different times, and under different administrations, held the position of Assistant Secretary for Policy Development and Research at HUD. The public may include state as well as federal agency representatives and/or legislators. The academic participants are the most likely candidates for research support. You may also include industry as you see fit. Whatever representation we can get from potential funding sources will certainly help in providing a scale that will be impressive as well as being of greater impact.

In my opinion, HHI would provide some funding for research even if at the outset we don't have others to join in. As John appropriately identified, there are short term and long term issues. The crisis is in the short term in order to avoid the disaster spreading.

But, the program could continue with long term issues. We will know a lot more about the future direction as a result of the roundtable.

The two of you, and any your co-chair(s) you choose to add, may determine the structure and schedule…

I have no clue as to budget having been away from this sort of a thing for a long time… We can pay travel for academics according the usual Weimer School standards. We will have the costs of the food, and possible place. It is much too early to have a picture of costs. But, once the two of you, and your colleagues, decide on the structure, invitation list, and the like, we would like to get some sort of a budget.

We have already committed an honorarium to Brent Smith for conducting the literature review which could take up to four weeks from the start which was this week

My personal thinking is that the high priority for research is to reduce the risk of a cascading of housing markets. While the chances may be small, the societal loss would be so great that it is prudent to move to reduce the risk. This is discussed in the draft which you may use as you please, or not. My preference is that both of you provide enough input to reflect your professional view of our roundtable objectives and use the final copy of the piece as a communication piece. It is pretty far along and Brent Smith may make your participation easier… My interest is in seeing that there is some unanimity in the objectives of sponsoring the research roundtable; the results will be whatever they turn out to be. We really have an excellent opportunity to make a difference through the development and dissemination of knowledge, which is what we do at the Hoyt Group.

That is the situation and I am personally delighted that the two of you are leading the effort with whatever team you choose, however assembled.

Maury

Setting Objectives

Subsequent to that discussion, the following emerged;

DISCUSSION DRAFT OF

This Research Roundtable is Committed to Developing a Research Agenda

This Research Roundtable is committed to developing a research agenda designed to (1) enhance understanding of institutional arrangements that would avert a **reoccurrence of the debacle caused by the subprime mortgage catastrophe**; and (2), to enhance understanding that would assist in the development of a strategy to **mitigate the damage from the current catastrophe**, especially to minimize the cascading of foreclosures that would destroy some local housing markets and spread to adversely impact the rest of the economy, especially to avoid a precipitous downturn in general economic activity.

As background to an understanding of what happened, a companion piece by Brent Smith provides the results of a review of the literature. An additional companion piece, “Don’t Panic Yet,” provides a perspective of a strategy to avoid the cascading of foreclosures and the spread of deleterious effects to the rest of the economy. However, various players in the system, public (federal and state level) and private will have various perspectives of what would be an appropriate strategy. This Research

Roundtable will provide a framework that may help them in their developing their own strategies. It is then up to them to use the enhanced understanding provided by (1) this preparatory work to the Research Roundtable, (2) the results of discussions developing the agenda for relevant research to be fostered, and (3) the research results that will emerge as a result of the combined efforts of the participants, the researchers, and the research supporters.

As an aid to being on the same page with the process, it is noted that everyone has some view of what strategy is, and a common ground of understanding strategy will help in working together. As a step toward that common ground, consider that strategy, as used here, starts with a vision. The vision is built upon a set of goals one chooses to pursue; but, strategy while capitalizing on strengths, considers the assessment of risks and the proclivity of risk avoidance, all as part of the process of attempting to transform vision to reality. The entire process is dependent upon underlying values as they affect choices.

The strategic process does well to consider such things as vision, balance, timing, control, location, leverage and relationships. The research agenda, along with knowledge already accumulated intends to work toward the vision of a stable market economy while maintaining and/or obtaining a balance of interests. Furthermore, the timing of reform will involve a process to remedy institutional relationships that are adverse to the **stability of a market economy and balance of interests**. Obviously, there are different views of what the balance should be, how much control should be provided by government, and how to leverage the efforts. While the companion paper “Don’t Panic Yet” has an imbedded set of values, it is provided only to help others in developing their own strategy which may be based upon different values or priorities.

This Research Roundtable will help in understanding relationships among the various players/sectors and enhancing their cooperation in obtaining the benefits of new knowledge gained from the research to be sponsored, especially through its application to the current debacle as well as avoiding a recurrence…

The vision of getting there needs to be translated into some program. That program is built upon the strategy. Underlying all these decisions is a set of values which may not even be articulated. They may be dramatically revealed when unfortunate events occur.

With this as background, we can now turn to enhancing understanding of institutional arrangements that impact the stability of a market economy, starting with housing finance and housing markets.

Flow of Funds: Cost and Availability of Capital…
…Risk Management: Borrower as well as Lender…
…Regulation: State as well as Federal…
…Private Sector Action: Various Organizations…
…Mitigating Damage: Focus on Current Situation.

Some of the results of research on long term reform can be utilized in the short term. This strategy needs to be thought through and might be a major topic of discussion at the Research Roundtable.

One particular project, not alluded to previously, is especially applicable to the short term. That project would identify local high risk areas. The Center for Responsible Lending has data that localizes defaults, although I don’t know how local.

It might be necessary to geocode the defaults in the area to get to a submarket. Brent is familiar with their data and we should talk about this project which is what I see as the highest priority in avoiding cascading…"

The next item is the invitation letter. It tells about the plan of the research roundtable.

I am pleased to invite you to participate with a distinguished group of academic and public sector leaders in a closed-session Roundtable discussion on "Developing a Research Agenda on the Subprime Mortgage Crisis." This Roundtable would consist of a one-day meeting in Washington, DC at the Hudson Institute to be held on October 24, 2007. This event is co-sponsored by Hudson Institute, the Homer Hoyt Institute, and the Institute for Urban Research of the University of Pennsylvania.

The purpose of this roundtable is to step away from superficial public arguments and discuss what is really needed -- in terms of research -- to solve the crisis, both in the long-term and the short term. The subprime mortgage crisis has two components: (1) the problems confronting homeowners who are unable to meet their mortgage payments, notably those with subprime ARMs that automatically reset to higher interest rates and payments after two or three years; (2) the appropriate policies and actions to prevent or minimize the risk of a repetition in the foreseeable future. Current policy attention is directed largely toward the first of these issues, but it is reasonable to anticipate that the second will attract increasing attention over time.

Since all housing markets are local, the problems confronting current homeowners, and the solutions, should be studied as both local and national issues.

We are inviting academic experts, representatives of industry associations, consumer advocates, officials from organizations representing state and local government, and key analysts from financial regulators. We hope very much that you will be able to participate. If you cannot personally attend but have a colleague who could, please extend the invitation to him or her.

The agenda is attached. To confirm your participation in the roundtable, please RSVP to Kathryn Kimball at Hudson, either (202) 974-6454, or kmkimball@gmail.com.

We hope to see you on October 24.

John C. Weicher
Director, Center for Housing and Financial Markets
Hudson Institute
On behalf of:
Maury Seldin
Chairman of the Board
Homer Hoyt Institute
[On behalf of]
Susan Wachter
Co-Director, Institute for Urban Research
University of Pennsylvania
[On behalf of]
Richard Green
Department of Economics, The George Washington University

The research roundtable program of October 24, 2007 is presented in Figure 3-1.

Figure 3-1

Subprime Crisis Research Program

Cordially invites you to…

Roundtable:
"Developing a Research Agenda on the Subprime Mortgage Crisis"

Wednesday, October 24

9:00 AM – 4:00 PM

8:30 a.m. *Registration and Continental Breakfast*

9:00 a.m. Welcome: **John Weicher** Hudson Institute
Maury Seldin Homer Hoyt Institute
Richard Green The George Washington University
Susan Wachter Institute for Urban Research, University of Pennsylvania

9:30 a.m. "Overview of the Subprime Mortgage Crisis"
Steven Westley Assistant Director
Financial Markets & Community Investment
U.S. Government Accountability Office

10:15 a.m. *Coffee Break*

10:30 a.m. "Policy Responses to the Subprime Crisis: Differing Perspectives"
(Richard Green, Moderating)
Patricia McCoy George J. & Helen M. England Professor of Law
University of Connecticut School of Law
Jack M. Guttentag "The Mortgage Professor" Columnist
Professor of Finance Emeritus
The Wharton School, University of Pennsylvania

12:00 noon. *Lunch*
Keynote Speaker: **Mark Zandi**, Chief Economist, Moody's economy.com

Closed Session:

1:30 p.m. What Do We Know? Issues and Evidence: **Susan Wachter**

2:00 p.m. Roundtable Discussions on Research Needs:
(1) Problems of Today – Subprime Borrowers in Trouble
(2) Issues of Tomorrow – The Economic and Political Future of Subprime Lending

3:30 pm Summary and Outlook: The Subprime Research Agenda

4:00 pm Adjourn

Location: Hudson Institute
Betsy and Walter Stern Conference Center
1015 15th Street, NW Sixth Floor
Washington, DC 20005
Tel: 202-974-2400
Please RSVP to Kathryn Kimball
at kmkimball@gmail.com

Funding the Program Activities

Preparatory to the meeting of the HHI Board of Directors, the following memo provides information on the next step.

MEMO

To: Ron Racster, President, HHI

From: Maury Seldin, Chairman, HHI

Subj: Budgeting $100,000 to the Mortgage Market Project in the HHI Strategic Plan

cc: Team leadership involved in design and implementation of the consortium leading the research roundtable and the related follow-up activities;

As discussed, at the HHI board meeting two days after the research roundtable the Board will consider allocating up to $100,000 for the Mortgage Market Project including the roundtable, grant support, and related activities. This will be in the context of the Strategic Plan in process for HHI.

Since the implementation of the contemplated program is heavily dependent on the co-chairs of the research roundtable, Susan and John, and the leadership team that they assemble, which includes Richard Green, it is essential that the HHI Strategic Plan take cognizance of whatever game plan emerges resulting from the cooperative efforts and results of the roundtable.

That leadership team requires some representation from HHI. Since you as president have the chief executive responsibility, it is your call as to how the representation is administered. I will of course continue as counsel to you to the extent that you desire, and as the co-chairs have requested use my name as Chairman of HHI in inviting roundtable guests and whatever other representation is appropriate. Since you as administrative link will be delegating lots to Ron D I have included him in the memo. Furthermore, since Brent has been selected for key assignments, and I have been working with him, and hope to continue, I have included him. Additionally, at Ron D's discretion he may call upon Brent for assistance, especially since we are looking to tie the Mortgage Market Project into the Real Estate Capital Flows Research Program.
<u>http://www.hoyt.org/capital_flows/index.html</u>

With that as background, here is a game plan discussion draft. Comments are invited from all who are copied and may be supplemented after the roundtable.

<u>Discussion Draft of Potential Game Plan for the Mortgage Market Project</u>

Objectives

The game plan is to develop a research agenda designed to (1) enhance understanding of institutional arrangements that would **avert a reoccurrence of the debacle caused by the subprime mortgage catastrophe**; and (2), to enhance understanding that would assist in the development of a strategy to **mitigate the damage from the current catastrophe**, especially to minimize the cascading of foreclosures that would destroy some local housing markets and spread to adversely impact the rest of the economy, especially to avoid a precipitous downturn in general economic activity.

The results of the research are likely to be applied by decision makers using their own paradigms, including their underlying values. Thus, such strategies as emerge will vary. Not everyone will buy into the same strategy, and it is not essential that there is total agreement on how to approach the problem. The objective is to provide one perspective as an example of a strategic approach with information that will help others in developing their perspective.

Approach

The approach is to develop relationships among decision makers and academics so that the academics can better assess the needs for knowledge by the decision makers and their representatives. The academics can then develop a research agenda that is responsive to needs and provide an opportunity for those who appropriately support such research to make the research funding available.

There are a lot of organizations involved in such a process. The approach is to work through organizations with the leadership of a consortium of three, the Penn Institute on Urban Research, the Hudson Institute, and the Homer Hoyt Institute. Susan Wachter, Co-Director of the Institute for Urban Research and John Weicher, Director of Hudson Institute's Center for Housing and Financial Markets are the co-leaders of the research roundtable and presumably will continue to lead the project through succeeding stages. Interestingly enough, Susan served as Assistant Secretary for Policy Development and Research under a Democratic administration and John served in the same position in an earlier Republican administration. Thus, both mainstreams of housing policy thought are represented in the leadership.

There is a third key member in the leadership team. He is Richard Green of George Washington University who is heading the May Session of the Weimer School of Real Estate and Land Economics where the topic will be the subprime fiasco. He is also current president of AREUEA which will have session on the topic in May 2008. ARES, the other real estate academic organization will hold a plenary session on the topic in April 2008 led, we think, by Susan and John and whomever else they include.

Both AREUEA and ARES are linked to decision makers in industry and government. That linkage is part of the plan.

The Program

<u>Stage I.</u> The research roundtable and its preparation constitute Stage I. The preparation includes a literature survey by Brent Smith and some associated commentary on the research agenda focused on utilizing a strategic approach. Additional preparation obviously is the program itself and selection of invitees to the closed roundtable session. The results of the research roundtable will be the start of the research agenda and the identification of players with whom relationships are being developed. All of this is in October of 2007.

<u>Stage II.</u> Stage II starts the evening immediately after the roundtable with the invitation to a few select organizations to join HHI in the development and funding of the research agenda. Those efforts will continue through November and December.

Based upon funding levels available, the research agenda will be scoped to a doable level in calendar 2008. The proposal is that the consortium of the three organizations will extend the joint venture operations for a total of fifteen months. There is a running start with the research and the time is critical. The current crisis should be over by the end of next year, although it will take time to get long term institutional changes.

Unless the Democrats snatch defeat from the hands of victory the next U.S. president will be a Democrat. While some changes will continue to be made under the current administration, additional changes can be expected in the next. As you Ron and I have discussed, we think that a Democratic Administration is likely to consider inviting Susan back to the Assistant Secretary for Housing Policy and Research position at HUD, or perhaps at a higher level. In any case, the fifteen month time table for the project seems to be the most feasible. Stage II concludes with a research agenda with some research started.

Some funding will be allocated during Stage II. As we discussed, HHI has no objection to funders providing direct support to researchers, not only for Susan and John, but for others. If funders find it more convenient to channel support through HHI, then HHI will accommodate them. If some funders have internal research organizations and their projects fit in with the research agenda, then they would be included in the plan.

Stage III. Stage III starts with the January Session of the Weimer School at which some time will be devoted to Faculty and Fellows discussing the agenda. Some faculty and fellows may pick up on some research ideas and proceed even without the consortium's funding. The output will be a fine tuning of the research agenda. It is uncertain whether any funders will be invited to the January Session.

Stage III continues in April with a plenary session at the ARES annual meetings. There may be some additional sessions depending on papers submitted. This and other parts of the game plan still need to be fleshed out. However, this will provide an open opportunity for academic presentations and those interested to attend to see what recent research has evolved.

The next part of Stage III is the presentations by the elite of the researchers on the topic as part of the May Session of the Weimer School. Richard is leading that session. The potential for publication out papers from this and other presentations has not been discussed much, but is a possibility.

The final part of Stage III is sessions at the AREUEA Mid-year Meeting. The character of that has not been planned, but that is the opportunity for the Washington DC types to participate without traveling. It should provide some good strategic options.

Stage IV is the completion of the funded projects and potential publication of results. **One option is the web with a connection from the HHI site. [Emphasis added.]**

Results

The benefits from such a project are difficult to assess. One problem is that we really don't know how much danger the economy is in. If we wait to see that the spillover affects from the mortgage crises damages housing markets so much that housing markets damages the rest of the economy to catastrophic conditions we will be too far gone to do much. Thus, it is prudent to be a yard over the chasm rather than an inch short.

Catastrophe aside, the system needs improving. That is what we do by fostering the development and dissemination of the body of knowledge in real estate and related areas. This is an exceptional opportunity to do well in the job of doing good. The sale of the condo should produce enough profit to support this program.

As noted, I am sharing this memo with the people that are involved in implementation and inviting their inputs. The Hoyt Group history and success story is built upon this strategy and we need some new programs to continue this process.

Maury

Developing Substance

The Subprime Crisis Research Program continued with lots of e-mails. One of which was as follows:

Emerging Research Agenda

The first draft of a home page for the project on HHI's website is up. The revision will be up shortly. There is a box on the left at the HHI home page, http://www.hoyt.org/

By now you all have received the draft of Brent's lit review and commentary. It will be posted shortly. The early draft was circulated in order to dovetail it to the roundtable agenda. The agenda and the draft are compatible. Here is what I saw as the draft outline, with minor revision and my labels, not Brent's

1. **Overview of Subprime Mortgages**
    a. Nature of subprime mortgages
    b. History
    c. State regulation
    d. Federal regulation
2. **Culpability of participants**
    a. Borrowers
    b. Brokers and lenders
    c. Wall street
    d. Fed
    e. Agents
    f. Appraisers
3. **Political Perspectives**
    a. Dollar exchange rate
    b. Local economies
    c. Elections of 2008
4. **Defining issues**
    a. Efficiency and equity
    b. Institutional arrangements
    c. Points to ponder

I think that structure works and fits with the agenda for the morning which sets up the discussion of the potential research which is the focus of the afternoon. Although Susan will summarize it as she sees most appropriate, it seems to me that the segue to building a research agenda might indicate that the short term and long term issues might be intertwined. I know that I advocated the top priority to staving off a cascading of deteriorating markets, and I see that the short term issues are listed first on the afternoon discussion.

At the risk of losing some of that thrust, I now favor the discussion start with focusing on institutional arrangements that facilitate remedying the mismatch in risk and rewards in the production of and investment in subprime mortgages. That is a longer term issue. It is also one that some potential funders may find of greatest concern.

Not that I expect that anything will unfold as visioned, but starting with some vision will help in orchestrating a concerted effort. If I were to organize issues in a logical sequence, I might come up with the topics as follows:

- Consumer education and protection
- Globalization and capital flows
- Institutional change and regulation

- Unstable markets and side effects
- Underlying values/philosophy and public policy
- Action responsibility by industry and government, federal and state
- Alternative strategies for current crisis and institutional change.

But, just as emotion may trump reason, interests may trump logic. Thus, if we take the really hot issue of institutional reform, with industry organizations getting a chance to see how they might develop strategies to make progress before the regulators called the shots, we might get some support for relevant research leading to industry reform.

At the same time, we might get government and consumer organization interest moved to develop alternative strategies. As noted earlier, not all have to agree on the same strategy. What we need is better forecasts of outcomes based upon better policies.

I looked over my various memos and saw a lot of material; so much so that it might be helpful to you if I selected some key excerpts that reflect my thinking and that will hopefully generate some feedback on what you all are thinking. This whole thing is a team effort; and most of what I can glean from the rest of the team's thinking is in the product such as roundtable agenda and invitation letter. I understand that a lot may change depending on what happens Wednesday and at the dinners. But, here are the excerpts as an attachment (that includes this lead in). [See Figure 3-2]

Figure 3-2

"Dinner Meeting" sent October 8, 2007

Hi Susan and John,

This is to share some of my thoughts on what we might do at the Wednesday dinner meeting. It is an informal gathering, without a formal agenda, but one or both of you will be guiding the development of the evening preparatory to the roundtable the next day and the cooperative effort for the ensuing year. The evening will no doubt unfold differently from whatever we plan, but you might share your thoughts with me on how you see it unfolding so that at least the three of us will be on the same page.

We are looking to enhance relationships with those that will be going forth with us in a cooperative effort. It might be nice to give each of our guests a few minutes to express their concerns and indicate their general approach to the problem. That could take a few hours, but the idea is to get the preview, not the presentation. It might work if you can constrain each to five minutes.

Once they have spoken, one of you might preview the agenda for the next day indicating that the polemics of the two presenters is a starting point to the development of alternative strategies to dealing with the issues. Any strategy is going to require an increased understanding of the system and potential outcomes of alternatives. What we will be looking for is the critical set of questions that can be addressed with a research agenda…

I am not optimistic about the level of detail that will emerge during the Research Roundtable concerning alternative strategies. What we may get is a framework for scoping out such strategies and identifying the areas requiring research in order to enhance the probabilities of success."

"Mitigating the Housing Market Crisis…

There are three sets of analytical issues. One is the set of conditions that make workouts better than foreclosure. The second is what organizational arrangements need to be made to implement the acquisition of the mortgages to be worked out and their administration. The third set of issues is revolves around avoiding chaos in the capital market and dealing with the ethical issues of incidence of losses.

Thus far the Fed's bailouts have revolved around providing liquidity to the investors in the mortgages, or the mortgage traunches, apparently with repurchase agreements. The incidence of loss, if the instruments are not repurchased, is not clear to me. Furthermore, the holders of the debt may take the foreclosure route and that is likely to exacerbate the softness in the housing market. The great danger is a downward spiral in prices because houses would be dumped on an already soft market. The strategy suggested here is to soften that blow by finding out what is the range in a potential workout where the lender is better off than foreclosure, and so is the borrower, and facilitating that process beyond existing institutional arrangements….

The second set of analytical issues is based upon organizational issues, especially institutional arrangements. The first question is to identify the role of the mortgage servicer in the process. If the servicer is a mortgage banker with the capability of acquiring the ownership of the mortgage, negotiating the restructures agreement, and selling the mortgage, that is an option. What is more likely is the existence of a bank or other financial intermediary with a local office with the ability to acquire the mortgage at a deep discount, renegade the terms, and retain it in its portfolio, or possibly resell after payment history is established. Such an operation may require an infusion of funds to the commercial bank or other financial intermediary. Initially it might be the Feds action, but participatory interests could be an option. This participatory interest is the same system that brought the trouble, but it may be workable if the risk takers are still there…

The incidence of loss is a big issue. The reason for the bailouts of investors should be based on avoidance of chaos in the capital market, not saving investors from there folly. The avoidance of chaos may mitigate losses of investors, but it is the byproduct. The second set of analyses is the design of institutional arrangements that would make the amelioration of damage to housing markets feasible, especially to avoid a downward spiral of prices.

The third set of analyses is the avoidance of chaos in the capital market. The Long Term Capital Management bailout was such a case. Some bailout actions have already been taken, but they are focused only on the capital market, not on the reduction of foreclosure issue. The strategy that may emerge is one that ties further bailout assistance to the mortgage holder's participation in the write down program, where appropriate. The lenders need to be willing to take their share of the losses as a condition of getting federal assistance. This third set of issues is dependent on some results from the two earlier sets…

HHI is not in the position to fund the whole project; but it doesn't need to be. What it can serve as is a facilitator of the process. At some point, industry may be willing to provide funding for the research…"

Some Questions and Discussions

The Hoyt Group, the informal name for the group of related organizations (See Figure 3-3) has informal discussions among the participants, most unrecorded. The next few entries shares some thinking.

My Dear Colleagues,

The answers to some questions about markets seem relevant to enhancing my understanding of what is likely to work with strategies to deal with the subprime debacle. The questions may seem simplistic, but as you may recall I am fond of saying that it the things we know that are not so that get us into more trouble than what we don't know.

We agree that housing markets are local (although there may be some exceptions in high end second homes). But, in a spatial dimension of geographic coverage, how local are markets? *The Wall Street Journal* front page story of October 11 is typical in the assumption that the markets are metropolitan areas. That is useful for some purposes, but if we want to put markets under a microscope in order to understand behavior, the geographic coverage needs to be limited to cover houses that are the subjects of competition; or, is it the potential buyers and sellers that are the subjects of competition?

In any case, in metropolitan areas there are submarkets where the competitive forces of the market are localized focusing on houses more or less substitutable one for another. The demarcation for analytical purpose may be sharp, but in the sense of fuzzy logic ("…as a way of processing data by allowing partial set membership rather than crisp set membership or non-membership…" see http://www.seattlerobotics.org/encoder/mar98/fuz/fl_part1.html#INTRODUCTION or *Fuzzy Thinking: The New Science of Fuzzy Logic* **(Paperback)** by Bart Kosko) there is interaction among submarkets.

Whether we use the word "submarket" or "market" to delineate the geographic area relevant to microscopic examination of market behavior we are not only interested interactions of buyers and sellers within the area, but also linkages to other areas. In order to better understand those linkages it is useful to understand something about the science of networks.[2]

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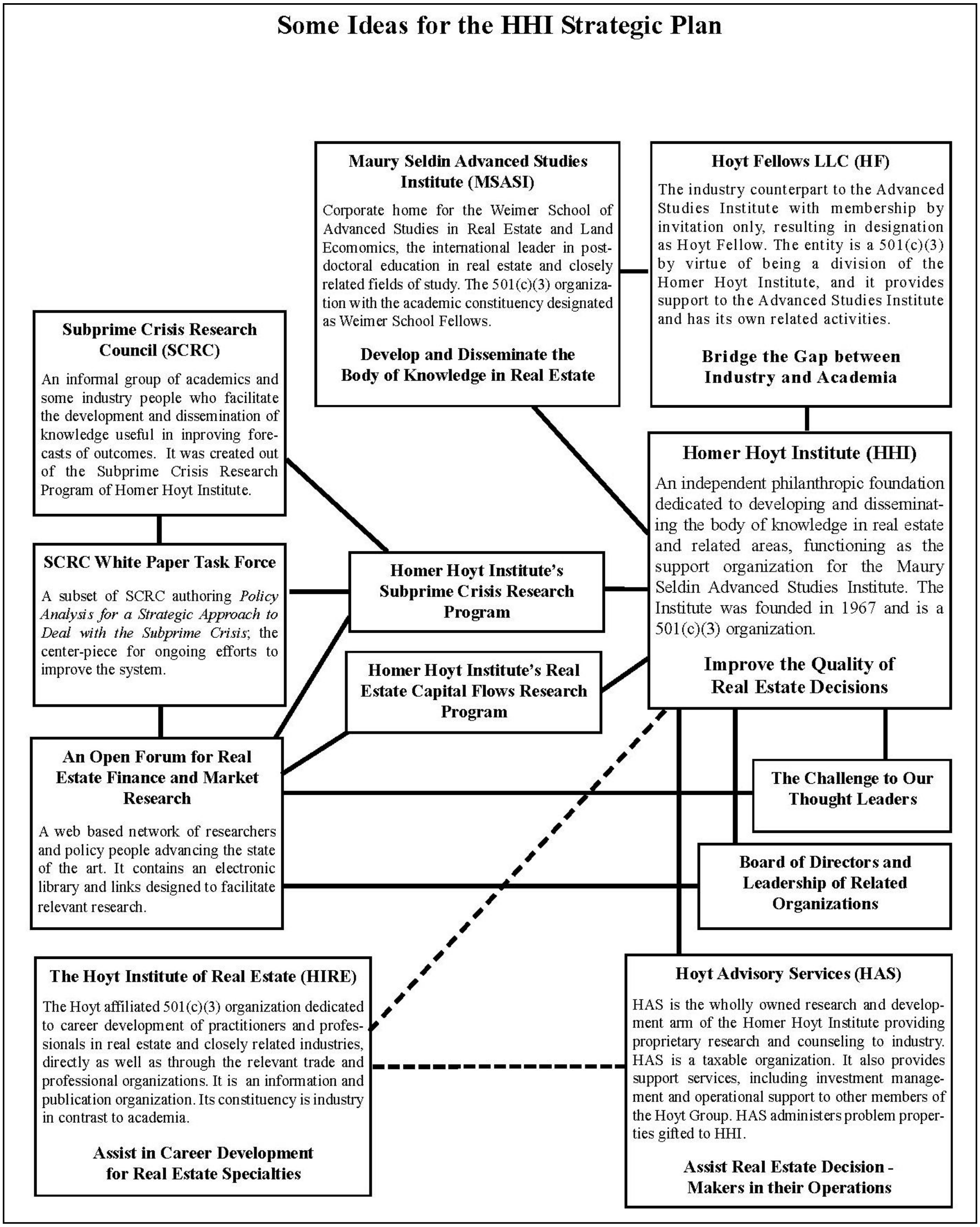
[2] The science of networks deals with the commonalities of systemic structure of linkages that form networks. Networks are composed of nodes that are connected.

The distribution of the frequency of connections among the nodes in a system is not random There is an interdependency within the system with the strength of ties among nodes varying. This is significant in that the predictability of the behavior of the system is dependent on understanding the underlying principles of the system.

As a result, "aggregate behavior is a reflection of the interaction of the individual behaviors that are influenced by each other. In other words, group behavior may be different from the summation of predicted individual behavior because the individual behavior is being influenced by the behavior of other individuals. Thus dynamics comes into the equation." [See Joe Podolsky's review of the book authored by Barabasi, *Linked: The New Science of Networks*, appearing in *The IT Journal*, Third Quarter, 2002.]

Figure 3-3


Some Ideas for the HHI Strategic Plan
Maury Seldin Advanced Studies Institute (MSASI)
Corporate home for the Weimer School of Advanced Studies in Real Estate and Land Ecomomics, the international leader in post-doctoral education in real estate and closely related fields of study. The 501(c)(3) organization with the academic constituency designated as Weimer School Fellows.
Develop and Disseminate the Body of Knowledge in Real Estate
Hoyt Fellows LLC (HF)
The industry counterpart to the Advanced Studies Institute with membership by invitation only, resulting in designation as Hoyt Fellow. The entity is a 501(c)(3) by virtue of being a division of the Homer Hoyt Institute, and it provides support to the Advanced Studies Institute and has its own related activities.
Bridge the Gap between Industry and Academia
Subprime Crisis Research Council (SCRC)
An informal group of academics and some industry people who facilitate the development and dissemination of knowledge useful in inproving forecasts of outcomes. It was created out of the Subprime Crisis Research Program of Homer Hoyt Institute.
Homer Hoyt Institute (HHI)
An independent philanthropic foundation dedicated to developing and disseminating the body of knowledge in real estate and related areas, functioning as the support organization for the Maury Seldin Advanced Studies Institute. The Institute was founded in 1967 and is a 501(c)(3) organization.
Improve the Quality of Real Estate Decisions
SCRC White Paper Task Force
A subset of SCRC authoring *Policy Analysis for a Strategic Approach to Deal with the Subprime Crisis*; the center-piece for ongoing efforts to improve the system.
Homer Hoyt Institute's Subprime Crisis Research Program
Homer Hoyt Institute's Real Estate Capital Flows Research Program
An Open Forum for Real Estate Finance and Market Research
A web based network of researchers and policy people advancing the state of the art. It contains an electronic library and links designed to facilitate relevant research.
The Challenge to Our Thought Leaders
Board of Directors and Leadership of Related Organizations
The Hoyt Institute of Real Estate (HIRE)
The Hoyt affiliated 501(c)(3) organization dedicated to career development of practitioners and professionals in real estate and closely related industries, directly as well as through the relevant trade and professional organizations. It is an information and publication organization. Its constituency is industry in contrast to academia.
Assist in Career Development for Real Estate Specialties
Hoyt Advisory Services (HAS)
HAS is the wholly owned research and development arm of the Homer Hoyt Institute providing proprietary research and counseling to industry. HAS is a taxable organization. It also provides support services, including investment management and operational support to other members of the Hoyt Group. HAS administers problem properties gifted to HHI.
Assist Real Estate Decision - Makers in their Operations

"Can the Mortgage Crisis Swallow a Town?" was a NY Times September 2 story about Maple Heights, Ohio. (Copy attached.) Maple Heights is a suburb of Cleveland. It has something over 10,000 housing units. Its housing market collapsed. What was the tipping point (see for example http://radio.weblogs.com/0107127/stories/2003/01/01/tippingPointNetVersion.html) in the collapse?

Maybe the literature of an earlier era dealing with racial balance in neighborhoods will shed some light on the percentage of housing units at which the market tips. But, do percentages change over time? Do they vary with demographics and psychographics?

In looking at those questions, how does the structure of mortgage debt influence the emergence process of housing market collapse? Emergence, as you will recall is combined behavior that is different from aggregating individual behavior. But, individual behavior leads to the tipping point. So, what are the risks with different mortgage structures and different individual behavioral characteristics?

Obviously, people who took teaser rate loans where the occupancy cost was less than a comparable rental, and the house was more than they could afford, except at teaser rates, were getting a free option. Free, except for the damage to their credit rating if foreclosure happened. But if they got "cash for keys" it even sweetened the deal – but the credit rating issue is uncertain or maybe irrelevant. But, there is a continuum of situations ranging from intent to capitalize on a bargain to being defrauded by misrepresentation in the marketing of the teaser rate loans. Included in the range are various degrees of lack of knowledge of the extent of risks and/or propensities to take risk. Contributing to the situation was the expectation of a continuation of the rising price levels of housing, interestingly enough fed by the loan terms.

Related to the rising price situation were the high interest rate loans for high risk borrowers. Some borrowers stretched under the belief that the market trend would continue and the higher cost would be justified. The cushion of equity or income was nonexistent and the change in expectation led to default.

Then there are those whose circumstances changes because of loss of employment or other financial reverses. A change in market expectations also comes into play as well as an ability of the market to absorb a sale in which the owner has little choice.

Do we have any models of these market dynamics? Are we able to reasonably forecast a tipping point in a local market? Are we able to reasonably forecast a migration of collapse from one market to another?

If we can get some good answers to these questions, then we have another variable to consider in strategies for dealing with the problems. Defrauded borrowers are a clear case under law. Uninformed or greedy borrowers are different. Also, differences between owner occupants and investors are considerations in who gets help. But, now comes he added consideration of emergence. Would it make sense to help an unworthy borrower in order to avert a cascading? Probably yes, but what about the uncertainty of whether that help will make a significant difference?

These short term considerations shed some light along term institutional changes. I'll leave the long term issues for another time, especially because I am really trying to keep this missive short.

I am grappling with these questions because the answers make a difference in what strategies will work, and there will be divergent strategies based upon divergent real politics. The values and the politics are what they are. What we want to avoid is the poor decisions because of the lack of knowledge. I see our job as helping develop effective strategies for institutional management, including assisting those in need, wherever those in a position to help find themselves on the spectrum of beliefs.

Maury

That e-mail was followed up by another e-mail that asked some more questions.

My Dear Colleagues [some more questions follow]

Some More Questions

Now for some questions about institutional arrangements that would reduce instability in housing markets. It seems that he current situation resulted from a mismatch in risks and rewards in the system of mortgage origination, packaging, and investing. In short, mortgage originators and packagers made risky loans sliced and diced to sell to investors where investors bore great risks with the great rewards going to originators and packagers.

My question is, how do you get institutional arrangements where those who bear the risks also get the rewards? The assumption is that such a system would provide greater market stability.

The thesis is that the rising housing market was fed by risky loans that should not have been made had the risk been borne by the long term lenders. Correcting the system would reduce the instability.

Markets perform useful functions in generating additional supply to respond to increasing demand, allocating stock, and setting prices. Some instability is inherent in the production cycle system and in the volatile cost of borrowed money. Arbitrary stabilization would cause more problems than would be solved. But, stabilizing some of the external forces affecting demand would help. How could that be done?

Much of this is a function of interest costs being a larger proportion of housing than in other goods. How has globalization affected the situation? How much of the lack of stable market systems abroad in developing countries (as outlets for investment), along with surplus cash to invest generated in part by oil revenues), generated excesses of domestic capital? How do we look at a system within a system, local housing markets in a global economy? And, what international policies are appropriate to move towards stabilization in financial markets?

Obviously we can't finish much in a single day, but how should the issues be scoped?

As a side note, I looked at the 25th Anniversary Book of the Homer Hoyt Institute, written fifteen years ago. It reported that the first HHI Research Roundtable was held in 1984 in Washington, D.C., on the topic "Innovations Needed in Real Estate Finance." Among the participants were a former chairman of the Council of Economic Advisors, the retired chairman of TIAA-CREF, and S & L industry leaders. A couple of pages from that report are attached.

You might also take note that in March 1990 the Advanced Studies Institute co-sponsored a conference "Housing Policy in the 1990's" with Wharton. Susan Wachter had become a Weimer School Fellow a few years earlier. Also, John Weicher, the Assistant Secretary for Policy Development and Research at HUD, was on the program. John became a Weimer School Fellow a few years earlier.

HHI is in the process of developing its current strategic plan. The Hoyt Fellows play a big role in that. They have a heavy tilt towards institutional investment. I am wondering about the role of housing in that strategic plan.

Maury

A Comment on Strategy

Figure 3-4 contains a comment on strategy.

Draft of September 14, 2007

Figure 3-4

Foreclosure? The Right Way to Play the Suit May be the Wrong Way to Play the Hand: A Strategic Approach to Averting a Crash in the Housing Market and its Fallout

Mortgage lenders, and representatives of mortgage lenders, consider foreclosure as an option when mortgage borrowers are in default. Mathematical models used to assess the profitability of the options may consider, in addition to foreclosure costs in legal expense and time, potential damage to the property and expected price to be realized. In order to reduce the costs the lender may offer cash for keys, i.e., a payment for a deed in lieu of foreclosure.

Each case may be considered on its merits, but what may turn out to be profitable on an individual case may be less profitable when considered as part of a portfolio of mortgages. The analogy to the card game of bridge is that the right way to play the suit may be the wrong way to play the hand…

…The analogy for foreclosures is that by foreclosing, or taking a deed in lieu of foreclosure, the lender adds another house to the local market and that market may already be flooded. The result may be to further depress already depressed prices and adversely affect the some of the rest of the mortgage portfolio, even in other geographical areas not competing with the houses in the subject property's market.

One may think that one more house on the market is not going to make enough difference to negate the mathematical model used to weigh the benefits and costs of becoming the owner of the property upon which their has been a default; the right way to play the suit. However, one should consider the classic case of the London's tragedy of the commons of medieval times in which everyone was free to graze on common land. The result was overgrazing so that the land was no longer suitable for grazing. No individual had an incentive to cut back on grazing their herd (the right way to play the suit) and there was no agreement at the time restraining the grazing. In later years such land came under ownership of a group of people who regulated the use among the common owners…

The idea here comes in two major parts. The first is to avoid a crash in the local market of a subject property. The second is to avoid a cascading of local market housing crashes. At first glance, many people will consider both cases as being remote possibilities, especially the latter.

Policy makers could wait until the possibilities seem less remote. The problem is that the longer the wait and the less remote the more difficult it becomes to avert…

Well, that may be more detail than most of the small readership of this document would like to see; but, for the few who want to get a picture of the culture of HHI and the project it is quite useful, especially for those who would consider supplementing the funding provided to date.

Summary Report on the Research Roundtable

The windup of this chapter is the summary of the research roundtable as reported in the newsletter. Here it is:

From "News from the MSASI/HFLLC", VOLUME XXII, ISSUE II (FALL 2007)

Don't Panic Yet: Strategies Emerging to Deal with Subprime Crisis
A Research Roundtable co-sponsored by the Homer Hoyt Institute (HHI), University of Pennsylvania Urban Research Institute, the Hudson Institute, and the Institute for Public Policy at George Washington University

Don't panic yet! Strategies are emerging to deal with the subprime mortgage crisis. A broad spectrum of options was discussed at a research roundtable sponsored by the Homer Hoyt Institute in conjunction with the Hudson Institute, the Institute for Urban Research at the University of Pennsylvania, and the Institute for Public Policy at George Washington University. The roundtable was held at the Hudson Institute in Washington, D.C., on October 24, 2007.

The roundtable included presentations and discussions ranging from the causes of the crisis, a variety of proposals to deal with it and prevent it from recurring in the future, and the outlook for the mortgage markets and the US economy.

In convening the conference, the sponsoring institutes noted that the subprime mortgage crisis has two aspects: (1) the problems confronting homeowners who are unable to meet their mortgage payments, notably those with subprime ARMs that will automatically reset to higher interest rates and payments after two or three years; (2) the appropriate policies and actions to prevent or minimize the risk of a repetition in the foreseeable future. Current policy attention is directed largely toward the first of these issues, but it is reasonable to anticipate that the second will attract more attention over time. Participants at the conference discussed both aspects in detail.

In addition, recognizing that all housing markets are local, the sponsoring institutes noted that the problems confronting current homeowners, and the solutions, should be studied as both local and national issues, and an appropriate research agenda should include both.

Steven Westley, Director of Financial Markets and Community Investment at the US Government Accountability Office, presented "An Overview of the Subprime Mortgage Crisis." Mr. Westley charted the growth of the subprime market and recent trends in foreclosures. He pointed out that defaults and foreclosures have been rising very rapidly among subprime ARM mortgages, but have not been rising for subprime fixed-rate mortgages or for prime mortgages. He also noted that the quality of subprime loan originations has been deteriorated steadily, quarter by quarter, over the last two years; each quarter's new loans have performed worse than the loans originated in the previous quarter. More and more loans have included risky features such as high LTV ratios, piggyback loans, and hybrid 2/28 mortgages with automatic resets that raise borrowers' costs sharply after two years. Problems have been most acute in growing states such as Nevada, California and Florida, and also in the industrial Midwest, in communities with economic ties to the automobile industry. Mr. Westley attributed the current problems to the much slower rate of price appreciation in many markets and the growth of subprime mortgage securitization, as well as aggressive lending practices. He further mentioned misaligned incentives and the lack of accountability in the origination and distribution of mortgages: originators have financial incentives to increase loan volume, potentially at the expense of loan quality, and expressed concern about the weak regulation of nonbank lenders.

Two widely diverse proposals for addressing the problem were presented. University of Connecticut School of Law Professor Patricia McCoy, whose research examines systemic risk and market failure in predatory lending, asked the question, "What Now?" and called for federal regulation to eliminate shoddy underwriting, not only of subprime mortgages but also prime ARMs with potentially severe payment shock and negative amortization loans. She also favored strengthening the legal rights of borrowers. Lender violations of federal underwriting standards for ability to pay and verification of income should be a defense against all foreclosures, and borrowers should be able to sue lenders for violating the standards. She concluded with a parting question: "What kind of society do we live in and what level of defaults are we willing to accept?" – in individual states and local markets, and in poor and predominantly minority neighborhoods.

By way of contrast, University of Pennsylvania Professor Emeritus of Finance Jack M. Guttentag, whose weekly column, "The Mortgage Professor," appears in many newspapers, offered proposals for "Fixing the Sub-Prime Market." Dr. Guttentag stressed the need to eliminate contagious credit shocks to investors, and felt that default spikes were outweighing the benefits of having a subprime market. He advocated creating "Sub-Prime Mortgage-Backed Securities," (SPMBS), with borrowers being certified as subprime by mortgage counselors, and with subprime loans carrying cash-flow insurance from private mortgage insurance companies (PMIs). The SPMBS would also carry a Ginnie Mae guarantee. Contagious credit shocks would be eliminated, and PMIs would monitor underwriting practices to protect themselves, and eliminate sloppy underwriting. He predicted that mainstream lenders would enter the subprime market with these reforms, and the "fast-buck guys" would leave.

Both Professor McCoy and Dr. Guttentag recommended amending the Truth in Lending Act (TILA) and the Real Estate Settlement Procedures Act (RESPA) so that borrowers would understand the terms of their loans before they made a commitment, and lenders would make firm offers, including rate locks.

In order to enhance the quality of policy decisions, a better understanding of the system is required. Such an understanding is enhanced by research, and data are critical for rigorous research. The luncheon speaker was Dr. Mark Zandi, Chief Economist and co-founder of Moody's Economy.com, Inc., where he directs the company's research and consulting activities. His recent areas of research include studying the determinants of mortgage foreclosure and assessments of the appropriate policy response to bubbles in asset markets. He documented the impact of the subprime crisis on financial markets and projected price declines in many local housing markets, particularly in California, Nevada, Arizona, and much of Florida, and also around Boston, Washington, and Detroit. He also projected a deterioration in the overall US labor market. In response to a question, Dr. Zandi estimated about a one-third probability of a recession in the next year.

Developing effective strategies to deal with the issues requires stepping away from superficial public arguments and identifying a research agenda that would enhance understanding of likely outcomes of different policies. Much of the discussion to this point was on institutional reform to prevent similar disruptions in the future. But, attention shifted to focusing on the short term problems. Part of that is dealing with the teaser rate escalations that are kicking in and that will generate more foreclosures. Another part is the potential cascading effect; a recent New York Times article described cascading as it occurred in the Cleveland suburb of Maple Heights, Ohio.

The research roundtable discussion then turned to efforts in developing a research agenda to provide the understanding necessary to facilitate a variety of effective alternative strategies. Since strategies will differ with underlying values and political perspectives, the research roundtable was designed to reflect the diversity of perspectives among housing and mortgage market participants and in American society. In part this was done by the selection of the co-chairs for the Research Roundtable, Dr. Susan Wachter and Dr. John Weicher.

Dr. Wachter, a chaired University of Pennsylvania professor, is Co-Director of the University of Pennsylvania Institute for Urban Research. Dr. Wachter served in HUD as Assistant Secretary for Policy Development and Research under a Democratic administration. Dr.

Weicher is Director of Hudson Institute's Center for Housing and Financial Markets. He served as Assistant Secretary for Policy Development and Research at HUD under a Republican administration. They were invited to co-chair and to co-sponsor the roundtable by Dr. Maury Seldin, Chairman of the Homer Hoyt Institute, as part of an ongoing effort dedicated to improving the quality of real estate decisions.

Also participating in the creation of the Research Roundtable was Professor Richard Green of George Washington University. Drs. Green, Wachter and Weicher are faculty members of the Weimer School of Advanced Studies in Real Estate and Land Economics, the international leader in post-doctoral education in real estate and closely related areas. Dr. Green will lead the May Session of the Weimer School which will focus on presenting the papers most significant to the development of effective alternative strategies for dealing with the subprime fiasco.

The research agenda, which is in the process of being developed based on the discussions at the research roundtable, will be vetted at the January Session of the Weimer School. It will be supported by the Homer Hoyt Institute and others who have expressed interest in participating. A plenary session and regular sessions on the topic will be held at the Annual Meeting of the American Real Estate Society for avoiding and dealing with debacles such as that generated by the subprime situation.

The audio tape of the research roundtable and the presentations of the speakers are available on the Hudson Institute website at:
http://www.hudson.org/index.cfm?fuseaction=hudson_upcoming_events&id=458.

Further information on the roundtable is on the Homer Hoyt Institute web site at:
http://www.hoyt.org/subprime/index.html

The site includes the results of a literature survey and other related items as follows:

- Introduction
- Literature Review and Commentary
- Research Roundtable
- Research Projects
- Don't Panic Yet

That tells the story of the opening Research Roundtable. About one year later, a first-year wrap-up was scheduled to be held on September 15; again at the Hudson Institute. That is discussed in the last chapter. The intervening activities start with the next chapter.