Panic Doesn't Help - Strategy Does: A Personal Perspective[1]

By Maury Seldin[2]

Preface

by Ronald L. Racster[†]

In the course of preparing the newsletter, in which the essay that follows is included, I asked Maury for his personal perspective of the status of the debacle and our efforts to bring additional research to bear. The essay is his editorial that expresses the personal and professional opinions of an insightful and analytical observer of our current mortgage and housing crisis.[3]

Dr. Seldin advocates discussion and cooperation among the diverse parties involved in the present mortgage and housing crisis. He is a strong proponent of independently conducted research to inform the parties of the potential outcomes of their actions or inactions. The Subprime Crisis Research Consortium is the vehicle organized to accomplish the research it deems most relevant and fundable within its resources. The initial funding, a $100,000 authorization from the resources of the Homer Hoyt Institute (HHI), is the limit of what HHI will provide, but it has been supplemented by a grant of $25,000 from Freddie Mac and expected grants of $25,000 each from the Mortgage Bankers Association and the National Association of Realtors. The Institute's funding is based on the program running for one year starting with the research roundtable held in October of 2007.

The issues, long term and short term, justify more funding than the current $175,000 and may take more than a year as a research program. If others also choose to supplement the funding, the research program can be more effective in improving the quality of decisions, which is what the Homer Hoyt Institute is all about. HHI has, through its support of the Weimer School of Advanced Studies and its Hoyt Fellows, an extraordinary set of relationships for the production of relevant research.

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[1]This essay is best read in conjunction with the essays that were inserts in the previous newsletter and the related reports in the current and previous newsletter. See the Hoyt website, www.hoyt.org.

[2]Dr. Seldin is Chairman of the Board of Directors of the Homer Hoyt Institute, an independent not-for-profit research organization dedicated to improving the quality of real estate decisions through the development and dissemination of relevant research.

[3]The essay does not necessarily reflect the opinions of the Homer Hoyt Institute, the Maury Seldin Advanced Studies Institute, or those of the Subprime Crisis Research Consortium. Indeed, the participants in the Subprime Crisis Research Consortium have diverse views and they, as well as the researchers supported by the Consortium, speak for themselves as do the participants in various meetings sponsored by the Consortium. This diversity is significant because communications among the parties are enhanced and the relevant research is a significant aid to the various parties in their decisions.

Panic Doesn't Help - Strategy Does: A Personal Perspective

By Maury Seldin

The Risks

Industry and National Economic System

A temporary moratorium on foreclosures! That was an idea advanced by Hillary Clinton on national television in a recent debate with Barack Obama[i]. That may put fear in the hearts and minds of industry – the federal government overriding private contract and acting in an area of what has been long established as a state's jurisdiction. Well, maybe industry would prefer standardization of regulation on a national basis, but overriding private contract to deny the major remedy for mortgage lenders when borrowers default could devastate future mortgage availability.

There is a lot of fear going around. Some people think that even the Federal Reserve is getting fearful; a ¾ percentage rate cut followed nine days later by another ½ percentage point. That was in January. Four months earlier The Federal Reserve acted quickly to ease an emerging credit crunch when Countrywide couldn't float its commercial paper as it usually did. That was mentioned in the insert of a previous newsletter along with the quote from the Wall Street Journal, "On Friday morning, following a conference call the previous evening convened by Chairman Ben Bernanke, the Fed blinked."[ii]

When we held the research roundtable in October the conventional wisdom was that there was about a one-third chance of a recession emerging. It didn't take long for the prevailing wisdom to be around a fifty-fifty chance. Now, with the declining gross domestic product of last year resulting in a 0.6% annualized rate of growth for the last quarter, it seems pretty obvious when considering other indicators that the first two quarters of 2008 will be negative and thereby meet the criteria for an official recession. The focus is shifting to how deep and how long, not if and when.

Okay ball fans, if you are not worried yet, at least fasten your seat belts, if I may mix the metaphors. Look at the price of gold and the decline in the relative value of the dollar compared to foreign currencies. Then, consider the double federal deficit, including a fiscal rescue plan to avert a recession, and the foreign investment in US assets and shifting away from the Treasuries as foreign currency reserves. The only bright spot is that the demand for our goods for export will be increased because of the cheapened dollar. That will be good until we get noises from foreign governments that we are competing unfairly.

If you don't think that you have enough to worry about, consider that if draconian measures are taken to deal with the subprime debacle we may get stuck with institutional changes that affect our mortgage securities markets, foreign and domestic. A major concern in dealing with the current crisis is that we don't make permanent some temporary changes that are essential to averting catastrophe. Some ideas on dealing with changes are discussed in the second essay provided as an insert in the previous newsletter.[iii]

As indicated by the title of this essay, "Panic Doesn't Help - Strategy Does," so don't panic, but reassess whatever strategy you have been pursuing.

Home Owners and the Economy at Large

When we started to look at the subprime crisis last year, the big issue was the resets due over the next couple of years that would be at interest rates that were not affordable and a situation where the market price declines had left the owners with negative equity. That situation was bound to lead to an increase in foreclosures. Based upon that expectation, the concern was the potential cascading of foreclosures. Guess what! The latest news is that a dominant portion of the foreclosures are not from resets. I haven't seen the numbers but it makes sense that the decline in prices has produced a lot of negative equity.

The request for proposals sent out recently did not include a request for an analysis of the conditions throughout the nation leading to the increase in foreclosures, broken down by the following: the usual causes for loss of income, increased carrying costs because of resets on variable rates, and drop in market prices below mortgage debt. We may get requests amounting to more than the funds available (although since drafting this NAR has joined in as a supporter) and we might address those issues for small areas selected for detailed study. But, it may well beyond our resources to get a good national sample stratified by local conditions. The point, however, is that a lot of homeowners are going to get foreclosed upon, and some of them were not borrowers on subprime loans. They just happened to have high loan to value ratios before a really large portion of the value evaporated.

We are concerned about all of these people, but less about the greedy few who knew that the home was beyond their means but were hoping to make a big profit in the housing market with ever rising prices. The homeowners of greatest concern are the homebuyers who were the victims of fraud or misrepresentation. Also of concern are those who needed consumer education but went ahead on deals that were not in their best interests, possibly being naïve and getting really inappropriate counsel, probably self serving.

We are trying to get some research in this area, but it will have to be on a small scale. At this writing we just don't know what is going to be doable with the budget available. We think that more support may come from industry and that possibly some support will come from consumer groups and government.

The concern goes beyond the home owners. It includes the general population. There the concern is a recession generated by the subprime crisis. That calls for broader support.

The situation developed when consumer spending was growing faster than personal income and was financed in some measure by home owners drawing equity out of their homes. Some is simply by refinancing, in some cases with a subprime loan. Another method is the equity loan, sometimes used after credit card debt gets very high, but sometimes as the old cookie jar. Another method, especially with the expectation of continuation of rising prices, is to sell a home with a lot of equity and buy a more expensive home with little or no down payment. In all of these cases consumers' spending may be at an unsustainable rate.

When the house price trend reversed not only was this source of cash no longer available, but the mortgage debt turned out to exceed the price which could be realized upon sale of the property. In many cases household spending had to be cut to reflect household income, and in some cases it was cut even more. In the worst cases, the house went to foreclosure and the family doubled up reducing the number of housing units occupied. In other cases there was a downsizing in accommodations. Also, the fear of what happened to others happening to oneself curtailed some spending.

It got even worse when the drop in spending caused the loss of jobs and those that lost the jobs spent less. It seems as though a downward spiral has started in some localities. The key is to stop the would-be spirals before they occur or to shorten them. That is addressed later as a matter of strategy.

Anatomy of the Housing Market

If you are a believer in the concept of consilience[iv] as I am, then you will see that principles from diverse disciplines have commonalities that enable one to better understand the system in one discipline by applying principles learned in a different discipline. A brief overview of the housing market is provided here in the context of the human anatomy.

The key to being healthy is to maintain a proper balance in the system. Disease flourishes when the system gets out of balance. So one may ask what is a good strategy for dealing with maintaining health.

Now everyone has a working idea of what strategy is. But, in a technical sense I use it to mean policies pursued en route to an objective that are particularly concerned with overcoming the barriers to achieving the objective – solving the problems. In health we are accustomed to the curative approach; set the broken arm or cut out the diseased organ. There is also the preventive approach; inoculate against the disease. But the best is the perfective approach; live right such as with healthy foods and exercise and rely on the self corrections built into the system to keep it in balance. Please see Exhibit 1 on next page.

The housing market got out of balance big time because the subprime mortgage availability and abuse facilitated a lot of buyers buying beyond their means and builders adding to the housing stock to meet the rising demand, both in quality and quantity. The market got drunk and it has an overhang; pun intended.

There is an excess supply of houses, some of which can be absorbed over a reasonable time, depending on the location. Housing markets are heavily local, second homes being an example of competition among localities. It is a little more complicated because cost and availability of housing may influence local economic growth which in turn influences the demand for housing. The Homer Hoyt Institute is supporting the research so that the forecasted outcomes of strategies can be enhanced in quality over what would it be without the rigorous research. It adds credibility because the quality of knowledge is really improved.

The shortcut is to follow my line of reasoning and then check out whatever you question· Housing is naturally cyclical because of a confluence of a number of conditions including that it is a long lived asset with annual production a small percentage of stock and a volatility of demand influenced substantially by the cost of mortgage credit. Furthermore, it is generally not mobile so that local market conditions may vary considerably from community to community, especially among communities with difference bases to the local economy. Most of the time the market is a pretty good mechanism for adjusting for excesses and shortages – it is sure better than relying on a tsar.

In the present case, for most local markets in deep trouble, it is really dangerous to rely on the market to shake out the excess supply by using price. For most of us, if our child has ever had a high fever I'll bet that the vast majority of us gave the child a baby aspirin and maybe used cool water to constrain the fever as much as practicable. We did that because an excessive fever can cause a lot of damage. So it is with house price declines.

My great concern is with the cascading[v] of the nature that occurred in Maple Heights,[vi] a suburb of Cleveland. The idea is that foreclosure begets more foreclosure. See one of the lead stories in this newsletter reporting on a study by Dr. Dubin at the Weimer School in January and which she is continuing, possibly in an effort to help identify turning points.

EXHIBIT 1

The Three Levels of Meeting Problems*

What happens when we are sick?

We turn to a doctor to cure what is wrong:
To stop an infection or repair an injury.
It is the most familiar way to treat an illness
- *after* it has occurred.
This is the CURATIVE level.

There is another level of medicine.
We now vaccinate to prevent polio;
And science continues to find new ways to
Protect us from disease after disease.
This is the PREVENTIVE level.

There remains a third level in the care of our bodies. Medical science seeks not only to cure and prevent illness but also to perfect our health; to bring new strength and zest into our daily life through fullness of health.

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This is the PERFECTIVE level.

And wherever we turn, we find the same
Three levels of meeting any problem….

IN OUR NATION — Democracy is an unfinished business in our land.

At the Curative level — Pass laws to eliminate legal injustice and economic hopelessness, wherever these may remain in the United States.

At the Preventive level — Recognize fully the interdependence of all groups in our society and all parts of our nation; realizing that no one can be sure of his freedom, or of his livelihood, when others are restricted in theirs.

At the Perfective level — Advance from adequacy to excellence in American Life; setting still higher standards of achievement for ourselves , and in service to mankind.

At the Curative level — Deter force by force – in competing blocks of nations which divide the world.

At the Preventive level — Create an enduring world order through world law, maintaining the peace through a world police.

At the Perfective level — With the peoples of the world now living within sight and sound of each other, *live as neighbors, everywhere on earth* – working to increase together all that is good for the Family of Man.

Whoever we are-

Whether we find the problem in ourselves, in our family, in our work, in our city, in our nation or in our world – what we do about our problems is ultimately determined by our character. And each of us is given the power: to shape his character, to train himself in good action, to choose between right and wrong,to raise himself and those around him, to better levels of life, practicing the wisdom of Micah: "To do justice, to love mercy, and to walk humbly before your Lord." (Micah 6:8)

*Excerpts from an ad placed by the Jewish Theological Seminary of America circa 1969. Copy retrieved courtesy of the Ratner Center for the Study of Conservative Judaism, The Library of the Jewish Theological Seminary of America.

In the case reported in the New York Times story about Maple Heights, a family left the area, abandoned the house, because they no longer felt safe. The house wasn't over-financed. Houses with reasonable financing may get thrown into foreclosure because the decline in prices makes the debt greater than the value and the neighborhood is not attractive enough to warrant waiting it out.

Since owners of houses with debt exceeding the price available in the current market have an option value (meaning they can stay with the ownership), which coupled with the high transaction costs of relocating can provide substantial incentive for an owner of a home with a negative value on paper to wait it out. What needs to be done is to get rid of the cancer that is driving the prices down.

Cancer is a loaded word, and some people will take offense at it. But it fits. A dictionary that I use[vii] characterizes it as an invasive growth that may metastasize (transfer the cancer to other parts of the body) and "any evil condition or thing that spreads destructively."

The options are to cut, burn or poison. Cutting is obviously the surgery. Burning is the radiation. Poisoning is the chemotherapy. If one does not make one or more of the hard choices, the cancer spreads – it causes change in other parts of the system and can become deadly. In our analogy, the question is when does it pay to intervene with such drastic measures?

Some of the research the Homer Hoyt Institute is supporting is seeking to find out when it pays to intervene– not for the medical issues but for the housing debacle. However, to continue with the analogy, there are a variety of reactions when one is informed of tests revealing a cancer. Obviously it depends on the kind of cancer and the individual, but if it is real serious, the reaction might start with denial and/or shock. When any disbelief is counterbalanced and shock subsided the next reaction might be to ask "why me?' Then maybe whom can I blame? Sooner or later it makes sense to come to grips with reality, and that reality may be to cut, burn, or poison. In the case of the housing debacle it may mean extraordinary measures.

I like a minimax strategy, which is a strategy that maximizes gains within the constraints of acceptable risks.[viii] In the present case, that means not developing as permanent arrangements things that may need to be done on a temporary basis. Don't continue the heavy drugs after the disease is gone and be careful of habit-forming narcotics. So if strong measures are needed that are suitable for the short term but not long term, handle them in an appropriate manner.

As is discussed in the short essay of the market as an icon,[ix] we need to make substantial changes in order to get a more effective market. With the consortium's limited resources we are focusing on the triage situation, but the request for proposal (RFP) has some attention to the longer term issues. Indeed, we adjusted the RFP to attempt to get some preliminary research results in a timely manner. See the RFP presented elsewhere in this newsletter.

As to Senator Clinton's comment with which I opened the body of the discussion, it would be disastrous on a national scale, and maybe wasn't intended on that basis. I don't know. But, national policy is needed as well as state, and the Fed was right to pump some liquidity into the capital market. It is also right to use monetary policy as best as it can to lessen the downturn and recession. The Fed was underwhelming in its oversight function of capital market institutional changes that led us into this mess.

The moratorium on foreclosures idea occurred to me really early in the process. And it was buttressed by the actions of legal authorities in Ohio that denied foreclosures on securitized mortgages because of inadequate documentation. But that was a tool that I envisioned applied by states, probably in local areas that had been declared an economic disaster area on account of excessive foreclosures, and in order to prevent a cascading of foreclosures in the area (a metastasization to other houses in the locality) and to avoid a spread of the disease to other areas.

The spread to other areas may occur when the attitudes of home owners in other localities are so influenced by fear that they cut spending with damage to the local economy. Also, potential home owners, even in areas without an exceptionally high amount of foreclosures, may defer buying for fear of the downside spreading to their area. The influence of fear should not be underestimated just as irrational exuberance should not be underestimated. The field of behavioral economics comes into play in order to understand that not all behavior of the players in the market is going to be rational. We needed a strategy for the various states and for the industry players as well as the federal government authorities. These strategies should be blended and mutually supportive.

We will return to some of this after a discussion of the anatomy of the capital markets as it relates to mortgage finance.

Anatomy of the Mortgage Market

Since the mortgage market is a subset of the capital market, much of our discussion will necessarily be of the capital market. The focus however, is to understand the flow of funds to finance home ownership.

That flow of funds uses mortgages or deeds of trusts to provide security for the repayment of the loan. The nature of the loan terms and the source of funding have changed dramatically since the Great Depression.

Prior to the Great Depression the prevailing arrangement was with owners having substantial down payments, but using a balloon note (meaning the entire principal was due at one time) for acquisition of the property. The mortgage was security for the note but common usage calls the note secured by the mortgage the mortgage. The mortgage was then typically renewed when due. That provided short term funds for a long term need.

The lack of liquidity of the Great Depression led to foreclosures because the lenders wouldn't renew. The innovation that changed things was the amortized mortgage, led by an FHA program. The Post-WWII housing boom was driven by demographics but fueled by financing. In addition to low down payment loans insured by the FHA there were even lower down payment loans guaranteed by the VA. Later private mortgage insurance contributed to availability of low down payment loans. The source of funds was typically local through savings and loan associations, savings banks, and commercial banks, although some national sources came through insurance companies using mortgage bankers or brokers. For the local financial intermediaries there was a mismatch of maturities. Mortgages were long term assets that were financed with short term deposits. The mismatch was handled as a bet not everyone would want to withdraw deposits at the same time. The safety net was a central banking system that could provide liquidity to local financial intermediaries.

The local character of sources of funds coupled with the western part of the United States growing rapidly called for some national links. The start, aside from insurance company lending, was when S & Ls in the West sold off 90% of some loans to savings banks, concentrated in the East, retaining 10% and servicing the loans. This still left a stake in the quality of the loan, an important element in the evolution of the system and the nature of the malady of the current system of securitization.

The federal government also led the way with moving to a national market in the establishment of Fannie Mae to provide a secondary market for government backed mortgages. That was followed by Freddie Mac, which buys conforming loans and securitizes them. The transition to securitization broadened so that in recent years it was easy to securitize even subprime loans, and without a regulatory system operating with safeguards comparable to those of the government-sponsored enterprises such as Fannie and Freddie.

On top of that, the securitized debt was cut into tranches and repackaged and leveraged such that the ultimate investor really knew very little about the underlying security except that the rating services rated them at an acceptable quality. The rating services turned out to be wrong and there is not much of a market for the end pieces. Furthermore, the financial institutions holding them ran into great liquidity problems. The mismatch of maturities was solved but at the expense of a mismatch of risks and rewards. The originators and syndicators took the rewards. The borrowers and ultimate investors took the risks.[ix]

That structure of the capital market serving the mortgage market is out of balance. In our medical analogy it has thrown-up. The guys doing the cooking were not eating their own cooking but serving it up in fancy forms. The health inspectors were not there, but the doctor sent some medication after the fact. Some changes need to be made in cooking and disclosure.

The consortium's RFP addresses these issues. But, our attention now needs to be focused on the strategic approach.

Strategy

Wisdom challenged decisions are widespread. The nation's healthcare system is dysfunctional with the competition based on costs by segmentation of providers and patients rather than on quality of service to the patients.[x] The housing debacle emerged from a dysfunctional mortgage finance system that evolved without proper attention to balance in the system. An additional quote from the essay referred to previously is as follows: "A major failing of the market in the subprime case emerged from a mismatch of the distribution of risks and rewards. Great rewards went to originators, packagers and distributors of the mortgages and investment instruments derived from their packaging and slicing-an'-dicing. The great risks were borne by borrowers and by investors who wound up holding the long term instruments."

Our society would do well to apply a strategic approach to the issues. The really interesting thing is that since we have a variety of interests and perspectives, we have a variety of strategies. The Homer Hoyt Institute recognizes this and has been serving in a unique capacity to explore the strategies being pursued by the various parties in order to identify areas in which better forecasts of outcomes could be fostered through relevant research. The Institute's strategy is to work with the diverse interests and facilitate team efforts, not only in getting the best research for forecasting outcomes but for enhancing understanding among the various parties as to their common interests.

The overview of the approach is the lead story in the previous newsletter and that is supplemented by a story on page one of this newsletter. A further background on the Homer Hoyt Institute history is on page v of the *Advanced Studies Institute in Real Estate and Land Economics Silver Anniversary Commemorative Book,* available without charge on request. It also lists the academicians[xii] involved who happen to be the leaders in the field nationally and internationally, and their counterparts, the Hoyt Fellows. This is an exceptional network of academics and industry consultants capable of relevant research.

The strategy seeks to minimize the risks to our society by applying the generally accepted standards and values recognizing diversity and process. In other words, neither HHI nor the consortium is providing the solutions; rather the research effort facilitates a process in which the players will work it out using such research results as they see appropriate. That process is to improve the quality of decision making by developing relevant research – research that will assist the players in better forecasting outcomes of their choices. Thus, you as a player may well consider revisiting your strategy in light of the knowledge being revealed by the research. In the meantime, you can use whatever you like from what I am freely sharing with you as my personal perspective.

The idea of the strategic process is to predict outcomes and adjust behavior, especially to deal with guarding against the downside of uncertainty. That process does well to consider the following: location, timing, balance, leverage, relationships, control, and vision, not necessarily in that order.

Location

For the housing debacle the micro locations are those with high foreclosure rates and prospective high foreclosure rates, especially due to interest rate resets and fallout from nearby foreclosures that are depressing prices and potentially generating a spiral. From a macro point of view it is the nation because of the impact of foreclosures on economic activity leading to a recession. There are other perspectives such as that of the states hardest hit and that of the lenders where the key locations are those in which they hold mortgages or mortgage interests. Since the various local markets are nodes with a variety of linkages and the scale may move down to individual properties or up to the whole system, we deal with the problem in the context of the whole system.

Translated that means that triage is necessary for the most cancerous areas and macro policy will help for the economy in general, but the operations on specific properties need to be dealt with on a micro basis. Identifying the locations is a high priority and HHI plans to fund a project that will provide to all the information and the best related detail available, each to consider in the strategy of the individual entity or organization.

Timing

The timing is a really troublesome issue because the problems are so far advanced. The academicians that do the research take a lot of time and the politicians look to act very quickly.[xi] Business organizations can move the fastest, except that with the securitized mortgages, especially with sliced interests, the servicers' authority has limitations. Also the information system as to owners of the tranches with different interests is inadequate for expedient actions beyond servicers' authority. If the best action is a modification of the mortgage, possibly a write down, that is a triage situation that needs concerted action between servicers and regulators in order to adjust authority by overriding contract where appropriate. That is a tough pill to swallow, and as dangerous as a narcotic. An alternative may be to have state government declare a temporary moratorium on foreclosure, but that may be worse. The strategy comes into play because an amputation may be necessary to avoid death; and, it a really tough question, especially because it goes to the issues of whose costs and whose benefits.

HHI will support research to forecast outcomes but the players need to make the choices. HHI will help in generating and is planning to provide partial support for a best practices workshop of the National Governors Association working with the University of Pennsylvania to deal with such issues, but it would make sense for industry to explore what it sees as criteria for intervention. That requires detailed loan data, servicers' cooperation, and some ethical as well as legal expertise. That is not in the request for proposals but HHI would be pleased to supplement it if industry supplied some additional resources, not only data and funding but participation to explore ethical issues. There are related issues of recourse of borrowers who have suffered from fraud or simply misrepresentation. The holder in due course code limits recourse, and that is another sticky matter which is also part of the balance issue.

Balance

Balance, rather the lack of it, is what got us all into this mess. Refer back to discussion of risk and benefits.

Balance is critical in resolving the ethical and legal issues necessary to get just results. Justice is key to the system, and the FBI investigations into criminal behavior may result in some just punishment, but it will not reverse the damage that has been done.

Substantial long term changes in institutional arrangements need to be made. The RFP is addressing that but a priority for funding will be the triage issues necessary to reduce the adverse impacts on the economy as well as relief for borrowers who were unjustly treated. Again, it is in the industry's interest to be proactive in facilitating a more equitable market structure or regulation, especially if they have any concern that a new administration may come up with onerous regulation with a pendulum that swings too far. And it will make a big difference if government agencies are forthcoming with progress in their research activities and in providing further cooperative efforts with industry.

There is a saying to be careful of what we wish for, we might get it. The industry lobbied for lax regulation and suffered from it. Sometimes we are better off getting what we need not what we want. That is not easy to do especially if we are not amenable to grasping what we really need and simply pursue simplistic statements of what we would like under other conditions.

Leverage and Relationships

The Homer Hoyt Institute has a marvelous tradition of using leverage because it is the support organization for what is now the Maury Seldin Advanced Studies Institute (they renamed it when I retired from what was then the Homer Hoyt Advanced Studies Institute, possibly because it could be a long time until I am dead and they are very gracious and generous). Anyway, the Advanced Studies Institute houses the Weimer School which educates the educators.

The system works because there is a superb network of academicians and industry leaders and relationships are strong, resulting in the magnification of results from efforts. The linkages make "six degrees" archaic. The connections, including those of the Hoyt Fellows (you can find out about all this by getting a copy of the Silver Anniversary Book), are really amazing. Compensation in the system is meager, mostly with token honoraria for the academics. The Weimer School is an invitation only organization and the selectivity makes it a great honor. The key professional administering the day-to-day operations more than pays for himself because he operates the wholly owned subsidiary, Hoyt Advisory Services, and generates consulting income that more than covers his salary.

The Subprime Crisis Research Consortium is led by two Co-chairs, Susan Wachter of the University of Pennsylvania and John Weicher of the Hudson Institute. As you may have noted from the last newsletter each of them was an Assistant Secretary for Policy and Research at HUD, but under different administrations. Each heads a unit within her or his home institution that is concerned with the issues at hand. There is an Executive Committee for the Consortium that includes Richard Green who is Chair of the Grants and Awards Subcommittee   His academic position is at George Washington University, but he also heads the forthcoming May Session of the Weimer School which will be devoted to the subprime topic.[xii] All three are members of the Weimer School Faculty. I am the fourth member of the Executive Committee of the Consortium. I retired from HHI a decade ago but stayed on as Chairman, an honorific position without operating responsibilities or salary for the position. (Some people laugh when I say I am retired; others just raise their eyebrows).

In addition, the Consortium has a Steering Committee. The Steering Committee membership, aside from the Executive Committee, some Weimer School Fellows and Hoyt Fellows, has representatives of organizations that are supplementing the Institute's funding. They are the most critical components of the leverage of the whole system. They are listed in the newsletter.

The Consortium welcomes more participation in its Steering Committee, which is a major outreach vehicle. Government, federal and local, organizations were represented at the roundtable and the symposium. Consumer advocate organizations were also represented.

The players who are ready to revisit their strategy would do well to consider developing relationships with the players having different interests. The subprime crisis is a rallying issue, and no one organization, not even the government of these United States, can do it by itself. It is a team effort and winners know how to work with a team.

Control and Vision

An overriding characteristic of strategy is that one's actions influences the actions of others. The simplest situation is a first-shot best shot situation. The current situation is among the most complex because there are some many varied interests at work, with different elements of power. It makes a lot of sense to know what you can control, and be realistic about the policies pursued.[xiii]

The point of this is two fold. First, the vision makes a difference. You can see what the vision has done with the Hoyt Group, but it was not done alone. Control is a deceptive power in that we may not really have the control that we think we have. That is because our actions influence actions of others and it keeps on going as events unfold. That is what strategy is about, because it deals with that uncertainty.

Progress in our society is made through organizations.[xiv] The Subprime Crisis Research Consortium is a new organization, about six months old. If it gains ongoing support from outside it could continue, but that is not the issue now. The issue now is what you, as players in this crisis, are going to do to enhance the quality of your strategy in whatever role you find yourself. That could be as an academic doing research, an industry organization, or a government organization.

Start with your vision – what do you want America to be as it is affected by this crisis? What environment do you want to live in and work in? And what do you want for your children, and their children? (See the essay in the Fall of 2002, "Rules, Fools, and Tools. The link is in the footnotes.) What new relationships are you going to make to deal with your issues and will you share some control in order to lever your efforts. Join in pursuing a better balance; it is not only justice, it is a better system for your long run interests unless there is a myopic and narrow view of those interests. The place is here and the time is now. Do something!

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[i] See on the web copy of the letter that Senator Clinton wrote to Secretary Paulson, http://www.hillaryclinton.com/news/release/view/?id=4491

[ii] See insert in the previous newsletter titled "Don't Panic Yet: A Strategy for Dealing with the Emergence of a Housing Bubble Resulting from the Interdependence of Space and Capital Markets." That is also available on the website, www.hoyt.org.

[iii] See "The Market as an Icon: The Case of the Subprime Mortgage Debacle.," and consider the first two paragraphs provided here for your convenience. "The current subprime mortgage debacle is a failure of the market. The institutional arrangements need to be modified if we are to buttress our faith in the system in which the market represents a good way to induce production and provide distribution using price as a vehicle.

"Perfect market systems have sets of conditions such as a level playing field with symmetric rather than asymmetric information and equal bargaining power among players. In the absence of some of these conditions, or with some shortfall, governments intervene with regulation in order to make the system work better."

[iv]The concept of consilience is authoritatively discussed by Edward O. Wilson in *Consilience: The Unity of Knowledge*. New York: Vintage Books, 1998. The idea is that there are principles common to different disciplines so that one may by understanding principles in one discipline learn something about another discipline. I discuss this in a book in progress that may be viewed in draft form on the website of the ASPEC Center for Scholarly Studies (ACSE), www.spicequest.com/acse/StrategicDecisions.htm. ASPEC is the Academy of Senior Professionals at Eckerd College.

[v]Cascading refers to a sequence of events in which the early events snowball into a mass action. See theory of networks in books such as Barabási, Albert-László. *Linked: The New Science of Networks*. Cambridge, MA: Perseus Publishing, 2002 and Watts, Duncan J. *Six Degrees: The Science of a Connected Age*. New York: W.W. Norton & Company, 2003.

[vi]The Maple Heights story was reported in a NY Times, September 2, 2007.

[vii]See page 304 of Webster's Encyclopedic Unabridged Dictionary of the English Language.

[viii]See McDonald, John. *Strategy in Poker, Business, & War*. New York: W. W. Norton & Company, 1950.

[ix]See the essay "The Market as an Icon: The Case of the Subprime Mortgage Debacle," an insert in the previous newsletter.

[x]See Michael E. Porter and Elizabeth Olmsted Teisberg, "Redefining Competition in Health Care," *Harvard Business Review*, June 2004, pages 65-76. Also see summary statement on http://www.isc.hbs.edu/soci-healthcare.htm.

"Redefining Competition in Health Care"

Michael E. Porter and Elizabeth Olmsted Teisberg

Harvard Business Review, June 2004, pp 64-76

The U.S. health care system is in bad shape. Medical services are restricted or rationed, many patients receive poor care, and high rates of preventable medical error persist. There are wide and inexplicable differences in costs and quality among providers and across geographic areas. In well-functioning, competitive markets, such outcomes would be inconceivable. In health care, these results are intolerable. Competition in health care needs to change, say the authors. It currently operates at the wrong level. Payers, health plans, providers, physicians, and others in the system wrangle over the wrong things, in the wrong locations, and at the wrong times. System participants divide value instead of creating it. (And in some instances, they destroy it.) They shift costs onto one another, restrict access to care, stifle innovation, and hoard information—all without truly benefiting patients. This form of zero-sum competition must be replaced by competition at the level of preventing, diagnosing, and treating individual conditions and diseases. Among the authors' well-researched recommendations for reform: Standardized information about individual diseases and treatments should be collected and disseminated widely so patients can make informed choices about their care. Payers, providers, and health plans should establish transparent billing and pricing mechanisms to reduce cost shifting, confusion, pricing discrimination, and other inefficiencies in the system. And health care providers should be experts in certain conditions and treatments rather than try to be all things to all people. U.S. employers can also play a big role in reform by changing how they manage their health benefits.

[xi]A related personal story is that a few decades ago, while I was at the university I received a phone call from a staffer at a Washington DC office. The City Council was considering some legislation and the aid asked me a question about something she read from a page from my first book, Real Estate Investment Strategy. I pulled a copy of the book and told her the answer was on the previous page. Then she told me that she only had a copy of the one page. So I read the passage to her, but she didn't grasp it. So I said come to the university and I will explain it. She said that wouldn't work because they were making the decision tomorrow.

[xii]A couple of years ago the May session included discussion of predatory lending. There was no funding available to further support research on implications and it was not a situation that would generate the kind of effort now underway.

[xiii]When I retired from The American University in 1990[i] and moved to Florida I became more involve with volunteer community service. I was astounded with the wisdom challenged decision making since I had been accustomed to Washington where I participated in national organization work and local service with a much higher standard of reasoning. Even the local organizations in Washington had a higher standard because the pool of talent that they drew from was more experienced than that in Florida. Since the Institute has always been a part time effort I started broadening my education to get a better understanding of the situation. I urge you to read the inserts to the ASI Newsletter. They are on the web.

[xiv]See "Management's New Paradigms" by Peter Drucker in Forbes of October 8, 1998.