

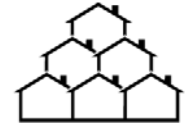
Affordable Housing Institute

The global pile-up in slow motion: risk, repricing, and housing

Presented at the IUHF 2008 Conference

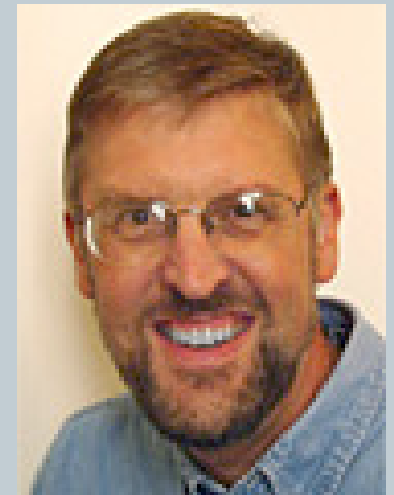
David A. Smith, Founder
The Affordable Housing Institute

Affordable Housing Institute and David A. Smith

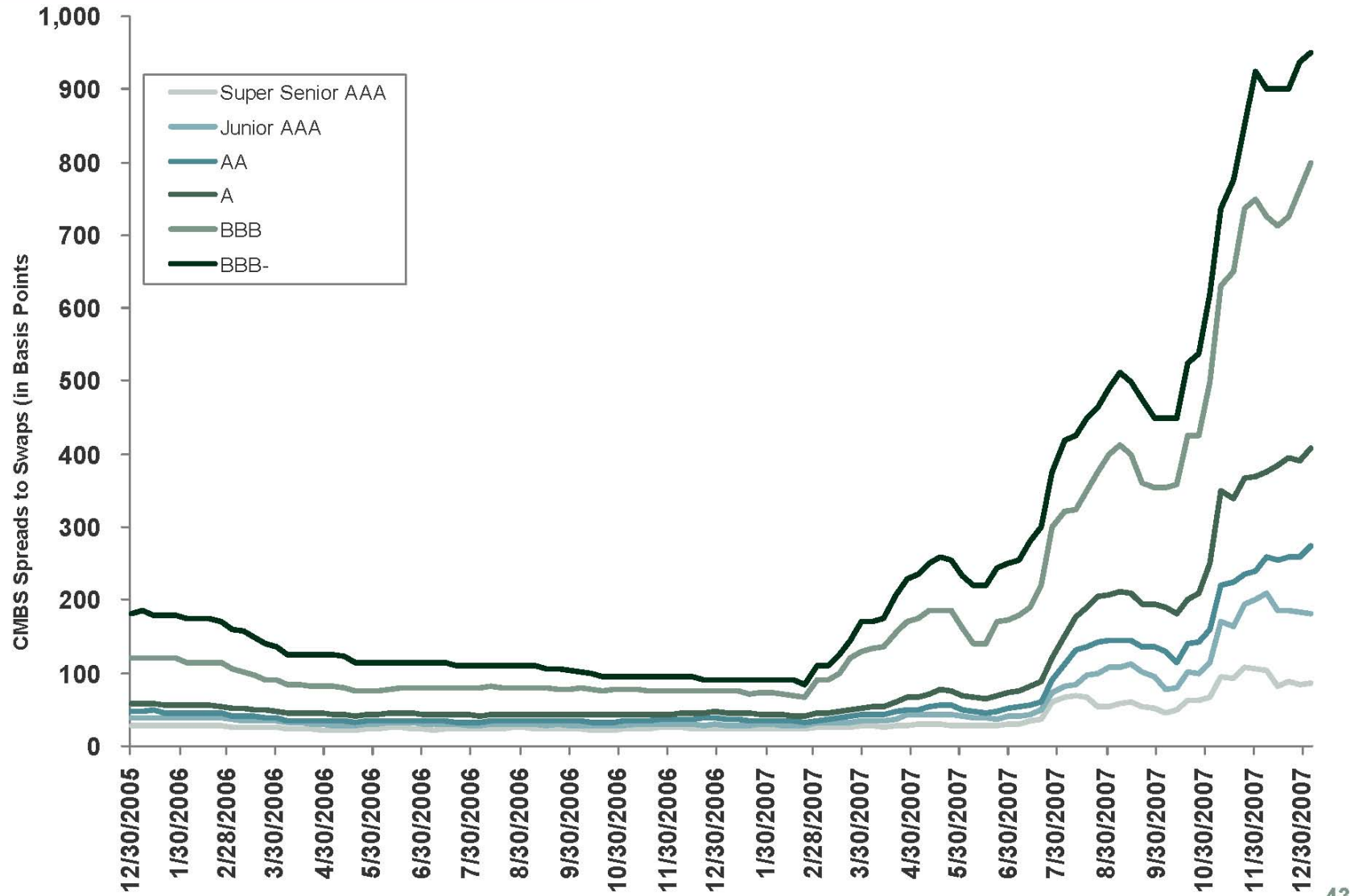


Affordable Housing Institute

- Developing successful affordable housing financial ecosystems worldwide
 - Ecosystem = mixture of laws, programs, entities, markets
 - Get the economics and incentives right, housing will follow
- Non-profit consultancy
 - “Pro-bono/ low-bono investment banker”
 - Worked in Egypt, India, Ireland, Kenya, South Africa, Sri Lanka, Turkey, UK
- Structured finance as applied to housing affordability
 - Public-private partnership, roles of government
 - www.affordablehousinginstitute.org
- 2008: Gates Foundation grant (research, two years)
 - Housing as the catalyst of urban improvement
 - Mission Entrepreneurial Entities (MEEs) as agents of change
 - Structured finance as key to MEE growth
- David Smith: 30+ years structured finance of affordable housing
 - For-profit (Recap Advisors), special service asset management
 - Affordable housing blog, <http://dasblog.org>



CMBS Pricing Changes Based on Changes in Single-family Market Conditions

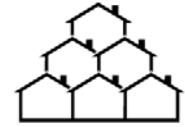


Source: MBA and Commercial Real Estate Direct

Mortgage Bankers Association

43

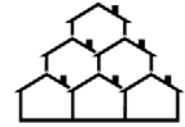
The mis-pricing of risk ... returns with a vengeance



Affordable Housing Institute

- Housing bubble? Risk grossly under-priced
- Home prices are a function of risk spread
 - Price is a function of its occupancy cost
 - ... which is a function of its financing cost
 - ... which is a function of its risk spread
 - When spreads skyrocketed, home prices fell
- Securitization led to losing touch with the assets
 - Extended value chain → investors unable to inspect assets
 - Tranching/ slicing → difficult to restructure, loss-mitigate
- Uniquely, the GSEs had infinite credit subsidy
 - ‘Credit subsidy’ = loan loss reserve (established by OMB)
 - FHA is rationed by law
 - Purely private companies are rationed by market forces
 - Until recently, GSEs were not rationed ...

“Catastrophe is a precondition to fundamental financial reform”

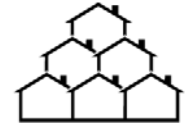


Affordable Housing Institute

- Crises lead to expanded/ improved rules
 - 1907 Panic → Federal Reserve Banks
 - 1929 Black Tuesday → SEC regulation
 - 1966 US riots → HUD housing programs
 - 1986 S&L bailout → RTC, FIRREA (appraisers)
 - 2002 Enron → Sarbanes-Oxley reporting
 - 2008 GSEs → The “Paulson Doctrines”
- The US has a distributed homeownership safety net
 - Entities that will respond to support affordability
 - Federal Home Loan Banks
 - State housing finance agencies (HFAs)
- Increased importance of permanent affordable rental
 - Workforce housing
 - Especially in coastal, growing-population areas

The “Paulson doctrine(s)”

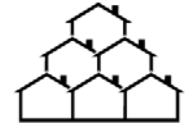
... “by their works ye shall know them”



Affordable Housing Institute

1. Prevent the Second Great Depression
2. Keep the GSEs in the loan-buying business
3. Intrude as little as possible in corporate governance
4. Support the debt holders
5. Discourage reliance (moral hazard)
6. Disrupt as few other markets as possible
7. Ignore depressed prices in favor of intrinsic value
8. Keep the optics good
9. Except as otherwise provided, let the market work

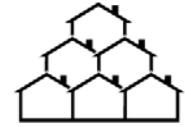
The post-bailout bank ... and post-bailout housing finance



Affordable Housing Institute

- Banking on value
 - Immediate-clearance price is not the only indicator of value
 - Can be depressed through short-selling panic runs
 - ‘Intrinsic value’ derived from objective methodology
- Everyone is a regulated institution now
 - Not just deposit-taking institutions
- The Bank of Glass: scalable transparent granularity
 - *Granularity*. Every asset specifically visible
 - *Transparent*. Every security holder can see every other position
 - Drill down right through waterfalls
 - *Scalable*. Roll up, aggregate
 - Imagine Google Earth ...
 - Dial your focus, dial your granularity
 - The only robust structures will be Banks of Glass

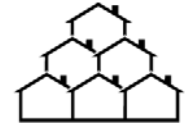
Post-bailout housing finance ... once the government is in, it's never out



Affordable Housing Institute

- Everybody needs a reliable source of long-term capital
 - Deposit-taking (backed by government)
 - Ability to sell securities (backed by government)
 - Ability to issue new securities/ bonds (government entities)
 - And the price is ongoing granular transparent regulation
- Role for government: issue and ration resources
 - Access to credit markets → sovereign-endorsed lenders
 - Federal Home Loan Banks
 - State Housing Finance Agencies
 - Numerous regional/ local issuers
 - Allocate, distribute affordability resources → money
 - Tax-exemption on bond interest (volume cap)
 - Interest subsidy (or mortgage interest deduction)
 - Grant/ tax credit resources

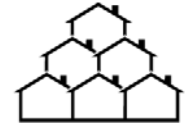
Whither Fannie Mae and Freddie Mac?



Affordable Housing Institute

- All this is pure speculation ...
- Private GSEs are valuable ... if under control
 - Limit their credit subsidy
 - Tighten capital requirements
 - Amounts relative to gearing
 - Narrow the non-cash forms of acceptable capital
 - MSR, deferred tax assets
 - Limit their ability to mismatch maturities
 - Prepayment risk, interest-rate risk
 - Stronger regulatory oversight (FHFA with teeth)
- More targeting, stronger affordability goals
 - Expand affordability at the margin
 - First-time homeownership
 - Increase rental, particularly workforce housing (global challenge)
- Will they call it Frannie?

Conclusion



Affordable Housing Institute

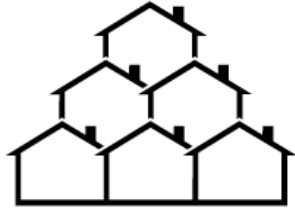
- The housing bubble was the symptom, the cause was mis-pricing of risk
- “Catastrophe is a precondition to fundamental financial reform”
 - Banking and housing finance will never be the same
- The post bailout bank: value, regulation, scalable transparent granularity
 - Google-Earth → web-based asset management
- Government has a permanent role in housing finance
 - Liquidity provider across the income/ tenure spectrum
- GSEs: re-privatized, newly chastened, tightly leashed?
- When in doubt, inflate your way out of debt?
 - Let’s hope not ...
- “The best way to predict the future is to invent it.”

Questions?



Affordable Housing Institute





Affordable Housing Institute

The global pile-up in slow motion: risk, repricing, and housing

Presented at the IUHF 2008 Conference

David A. Smith, Founder
The Affordable Housing Institute