The Mortgage Mess, the Press, the Politics of Inattention, and the CBO Working Paper

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Introduction

• Focus on “Mortage Mess, the Press and Politics of Inattention” with Roy Lowrance

  – CBO paper is informative, but not as they think

  – Reinforces importance of Debbie Lucas and CFP
Introduction

• January 28, 1986
• Space shuttle Challenger breaks up on take off from Kennedy Space Center, Florida
• Rogers Commission
• Richard Feynman and O-ring
Introduction

• Fast forward 21 years to housing finance crash
  – Why is our understanding so limited?
  – Where does the CBO paper fit?
  – What role does the press play?
  – Will the experts strike back?
Heat or Light

• Game with four players:
  – Scientific experts
  – Press
  – Public
  – Politicians
Heat or Light?

Scientific Experts

Press

Public

Policy Makers
Heat or Light

• Ideal response to bad event:
  – Scientific experts:
    • review events
    • develop reform proposals
  – Press communicates proposals
  – Public pressures for reform
  – Politicians undertake reform
  – Applies whatever the source of information
Heat or Light?

• Replace ideals with people
• Policy choice: supply information or not?
• High pressure for shuttle
• Low for housing finance
  – Ideologically-aligned editorials and tweets
  – No real light shed
• Experts retreat to ivory tower
  – Safe harbor
Heat or Light?

- High pressure for shuttle
- Low for housing finance
  - Ideologically-aligned editorials and tweets
  - No real light shed
- Policy makers retain control
  - Inertia since no change in forces
- Experts retreat to ivory tower
  - Safe harbor
Heat or Light?
PR or Reality?

• Desire to sideline experts widespread
• Revisit Challenger Enquiry
• Feynman—safety culture problems
• Chairman Rogers sought to exclude
  – Feynman refused to sign
  – “Appendix F – Personal observations on the reliability of the Shuttle”
PR or Reality?

“NASA owes it to the citizens from whom it asks support to be frank, honest, and informative, so that these citizens can make the wisest decisions for the use of their limited resources. For a successful technology, reality must take precedence over public relations, for nature cannot be fooled.” [Feynman, 1986]
PR or Reality?

- Federal Housing Administration (FHA)
  - Issues 96.5% LTV mortgages

- Annual Actuarial Reviews for Congress:
  - One year ahead projections for Insurance Fund for 2005-2013

- Projection errors assessed ensuing report
PR or Reality?

- In 2006 actual performance fell short of projections by $1.85 billion.
- In 2007 actual performance fell short of projections by $9.84 billion.
- In 2008 actual performance fell short of projections by $12.2 billion.
- In 2009 actual performance fell short of projections by $5.1 billion.

- Notice a pattern?
PR or Reality?

• Reverse mortgages (HECMs) responsible?
  – Excluded from 2010 on

• Unexpected house price declines?
  – Big turnaround in house prices - increase in builders’ share values 2012 and 2013
  – Turnaround in prediction errors?
PR or Reality?

• In 2010, actual performance fell short of projections by $2.7 billion
• In 2011 actual performance fell short of projections by $9.8 billion
• In 2012, actual performance fell short of projections by $22.8 billion
• In 2013 actual performance fell short of projections by $5.3 billion
Heat or Light?

• Evident to concerned experts
• 2010 paper “Reassessing FHA Risk” (Aragon et al.) identified biases in risk assessment:
  – underestimation of underwater FHA borrowers
  – inflated house values that lower loss estimates
  – failure to incorporate mortgage delinquency data
  – ignoring new down-payment assistance programs despite high losses on past programs
Heat or Light?

• Main bias cruder
• In the early 2000’s, FHA terminations by sale etc. removing risk from the FHA books.
• Since 2008, dominated by “streamline refinances”
• Treated as if successful exit like selling home
Heat or Light?

- Andrew Caplin, Testimony to Congress March 11, 2010

- “The problems in the actuarial review first came to our attention when Joseph Tracy, Executive Vice President and Senior Advisor to the President of the Federal Reserve Bank of New York, noticed that FHA prepayment behavior changed radically in 2009. Many mortgages that were significantly under water, which traditionally do not prepay, suddenly started to prepay. It is as if a group of particularly sick patients at a hospital suddenly appeared cured. .”
Heat or Light?

“..the cause of this apparent miracle cure turns out to be poor record keeping when one FHA mortgage is “streamline-refinanced” into another. To use the hospital analogy, it is as if very sick patients had been moved to a new room for treatment, yet were recorded as having been cured and discharged from the hospital. .. With this form of record-keeping, a hospital could boost its apparent success rate by moving patients frequently between rooms.”
Heat or Light?

- **Key Point:** To track the risk, follow the borrower not the mortgage

- FHA aware:
  - Joe Tracy and I met Chief Risk Officer

- FHA technically capable:
  - 2010 Congressional report removes streamline refinancing to praise new 2009 borrowers
Heat or Light?

• Impact of FHA on homeownership also requires linkage data
• Joe Tracy requested linkage data
  – Request met with silence
  – Two years research with imperfect alternatives
  – 2012 paper “Is FHA Creating Sustainable Homeownership?”
  – Short answer: No
  – Second testimony to Congress December 1, 2011
Heat or Light?

• Unlike Joe and I, CBO can get linked data from FHA
  – Allow you to follow the borrower through the sequence of FHA mortgages

• If CBO part of the solution, analyze linked data for loss projections and sustainability

• If CBO part of the problem, use unlinked data
  – Dropping streamline refinances from the estimation is worse than FHA approach
Heat or Light?

• Page 17: “streamline refinances are excluded from the analysis”

  – Analysis of stay in first ward when hospital undergoing once-in-a-lifetime refurbishment

  – Lesson: in this case CBO is part of the problem not part of the solution
The Press is Part of the Problem

• A concerned and expert press would:
  – Notice flaws in actuarial reviews
  – Ask about impact of U.S. housing finance policies on sustainable ownership
  – Insist on expert access to full data
  – Look for systemic causes and broader importance

• Not the press we have
What Next?

• Policy makers control not only data but reform
• Return to NASA Post Challenger reforms completed June 1987
  “Sweeping personnel and organizational changes begun immediately after the accident are now complete. ...Special attention is being given to the critical issues of management isolation and the tendency toward technical complacency, which, combined with schedule pressure, led to an erosion in flight safety.”
What Next?

- September 29, 1988 Shuttle mission 26
- Fast forward <15 years
- January 16, 2003
- Shuttle mission 113
- Columbia broke up on re-entry over Texas
Neglect is not Benign

- CAIB report echoed Feynman

- “Organizational Causes: A Broken Safety Culture”
What Next?

“This culture ... acted over time to resist externally imposed change. By the eve of the Columbia accident, institutional practices that were in effect at the time of the Challenger accident—such as inadequate concern over deviations from expected performance, a silent safety program, and schedule pressure—had returned to NASA.”
What Next?

- General problem: policy makers who make themselves invisible currently invulnerable
  - Without experts performance cannot be assessed
  - Liberates spinners: positive for most in press
  - Fertile soil for housing crash of 2025, bailout of 2027
  - How many other disasters are brewing?
What Next?

• Experts are enablers:
  – Research based on available information
  – Suppression induces neglect
  – Neglect enables policy dysfunction
  – Neglect enables press superficiality
The Experts Strike Back

• Best possible case
  – Experts encouraged to leave tower
  – Place policy process under microscope
  – Place press expertise under microscope

• This is where Debbie Lucas and CFP come in
The Experts Strike Back

- To current and future colleagues in the words of Dr. Seuss

  “Unless someone like you cares a whole awful lot, nothing’s going to get better. It’s not.”
The Experts Strike Back
The Experts Strike Back