Subprime Tsunami: What Next?

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Sand Hill Econometrics
Improve our Indexes of House Prices

Three ways to measure house price changes:

Case-Shiller: *house prices down 9% in 2007*
- repeat sales
- covers 20 cities
- treats foreclosure sales like all others

OFHEO (now FHFA) *house prices down ½ % in 2007*
- repeat sales
- covers the nation, sub-jumbo
- throws out foreclosure transactions
The Middle Way

Use repeat sales (more informative than average sale prices)
Use all transactions, including foreclosures and jumbo
Adjust the foreclosure transactions appropriately

<table>
<thead>
<tr>
<th></th>
<th>Case-Shiller</th>
<th>OFHEO</th>
<th>Middle Way</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007</td>
<td>-9%</td>
<td>-.5%</td>
<td>-4%</td>
</tr>
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</table>

Things are not as bad as newspapers make them look.

*Can the crisis possibly be less severe from reporting worse-than-actual price declines?*
Fix Fannie Mae and Freddie Mac

Losses: much *less* stressed than other mortgage holders.

Capital: *more* stressed, because they were more thinly capitalized.

Role: Still essential for providing liquidity

If we did not have them, it would be in the interest of all lenders to create something similar.

But doing this is difficult because of the tension between large vs. small banks. So fix the ones we have.
Fannie and Freddie did NOT cause the crisis.

F&F cannot originate or securitize subprime loans.

F&F can and did buy better-rated pieces of subprime MBS from others.

Boom in prices provoked by subprime lending spilled into rest of market.

<table>
<thead>
<tr>
<th></th>
<th>Portfolio</th>
<th>MBS</th>
<th>Subprime</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fannie</td>
<td>$900 bn</td>
<td>$1.8 trillion</td>
<td>$50 bn</td>
</tr>
<tr>
<td>Freddie</td>
<td>$800 bn</td>
<td>$1.8 trillion</td>
<td>$175 bn</td>
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</table>
What to change?

Charter as special purpose banks, explicitly guaranteed

Insured deposits are not part of federal debt, nor will this guarantee be
No industrialized country has a laissez-faire mortgage market
No effort to get the 30-year fixed-rate loans out from under the Federal umbrella has ever succeeded. (1968, 1989)

Capital requirements parallel to those of banks (phased in)

Supervision like that of banks
New Topic

Venture Capital
<table>
<thead>
<tr>
<th>Year</th>
<th>$ invested</th>
<th># of rounds</th>
<th># of acquisitions</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007</td>
<td>$29 bn</td>
<td>3925</td>
<td>436</td>
</tr>
<tr>
<td>2008 (1st half)</td>
<td>$30 bn</td>
<td>3600</td>
<td>350</td>
</tr>
<tr>
<td>2008 Q3</td>
<td>$30 bn</td>
<td>2804</td>
<td>360</td>
</tr>
</tbody>
</table>

*All figures at annual rates*
Some good news: venture capital

![Graph showing venture capital trends from 1989 to 2008. The graph compares the Sand Hill Index and the DJ Wilshire 5000. The Sand Hill Index spiked in 2000 and then declined, while the DJ Wilshire 5000 showed a steady growth.]