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Financial Innovations Labs

Housing: Beyond the Crisis

October 7, 2008
 Washington, D.C.

From the subprime meltdown to the unprecedented government bailouts, the current turmoil in the mortgage market is sending shock waves across the political and financial landscape. Federal and state legislators are struggling to find the appropriate regulatory response, capital markets are refining their financing models and the future of housing in America is at risk.

To address these critical issues, the Milken Institute hosted a Financial Innovations Lab on October 7, 2008, at the German Marshall Fund in Washington, D.C. "Housing: Beyond the Crisis" focused on incentives, market structures and regulatory mechanisms that would enable home buyers to continue obtaining credit from banks, maintaining a flow of financing for affordable housing that is both efficient and attractive to investors.

Bringing together researchers, policymakers, and business, financial and professional practitioners, the Milken Institute's Financial Innovations Labs aim to create market-based solutions to business and public policy challenges. Participants in this event included governmental officials, bankers, academics, lawyers, policy advisors, and representatives from rating agencies and nonprofit organizations as well as other experts from the housing and capital markets. The Lab was convened to explore financial innovations that would allow risk-sharing in the housing and mortgage markets, and most importantly, generate concrete plans of action.

The Lab was split into two sessions: one on capital market solutions and the other on affordability products. Both sessions featured presentations and case studies, followed by lively and provocative discussion among the 45 participants. The morning session, moderated by Phil Swagel of the U.S. Treasury Department, focused on current capital market solutions: securitization, covered bonds and shared equity products.

Panelists Tad Rivelle of Metropolitan West Asset Management, Tom Deutsch of the American Securitization Forum and Frank Nothaft of Freddie Mac analyzed the recent problems with securitized products and ways to use these products appropriately. The latest data demonstrates that the deterioration of collateral caused the current wave of massive deleveraging. Much of the discussion focused on the measures necessary to reboot securitization and other financial instruments to promote liquidity and lower costs while increasing transparency. All participants urged a return to the fundamentals of risk analysis in mortgage products and markets. Additionally, the panel recognized the need for a process to unwind securitizations to address bad loans.

Trip Foley of the Treasury Department and Alex Pollock of the American Enterprise Institute focused on the increased use of covered bonds, noting their success in Europe. Unlike asset-backed securities, covered bonds remain on the issuer's consolidated balance sheet and are backed by a pool of assets in case the originator becomes insolvent. They hold great potential, but participants raised questions about how much regulation would be needed to define and standardize this market, as has been done in Europe.

The concept of shared equity products, in which investors receive a portion of the equity in a home in exchange for providing a portion of the down payment, was analyzed by Ralph Liu of AeFT Inc. and Jim Gray of NCB Capital Impact. Gray argued that these products ensure occupancy, promote ongoing maintenance and avoid foreclosure; he believes they are effective, sustainable and durable. Liu presented his SwapRent model, in which distressed homeowners can essentially switch to renting their property through an economic landlord, who would credit full or partial monthly payments toward the homeowner's mortgage while sharing any appreciation in the value of the property.

During lunch, the participants enjoyed a presentation by John Courson, incoming president of the Mortgage Bankers Association, who discussed the future of real estate as an investment and the industry's strategies in moving forward.

The afternoon session, moderated by James Barth of Auburn University and the Milken Institute, shifted the focus to risk-sharing innovations and the potential for these products to revive the market. Dan Kildee of Genesee County, Michigan, presented the model of Genesee County's land bank, a public authority created to efficiently acquire, hold, manage and develop tax-foreclosed properties, as well as other vacant and abandoned properties. Kildee maintained that the use of land banks could help communities prevent foreclosures and spur housing renovations and new development.

Catherine Godschalk of Self Help outlined her organization's lease-to-purchase product, which is currently being piloted in North Carolina. This model creates a credit enhancement in the securitization process, buying loans from lenders to be subsequently resold to Fannie Mae and repackaged. These 30-year fixed-rate mortgages would offer borrowers a lower mortgage payment than other saleable financing choices. The organization also stresses borrower counseling, an important factor in the day's discussion of transparency in lending.

Adam Levitin of Georgetown University Law Center offered his perspective on how modifications in bankruptcy law could enable financially distressed individuals to renegotiate terms of their mortgages, lowering foreclosure rates and improving value recovery. Finally, John Weicher of the Hudson Institute discussed the limitations of payment assistance programs, especially seller-financed models, which seem to offer little benefit to homeowners while producing higher default rates. Other down-payment assistance programs that might be designed without such moral hazard were considered.

Finally, Jason Bordoff of the Brookings Institution and David Wyss of Standard and Poor's exchanged views about how the election will influence the direction of the housing and mortgage markets and what lies ahead when the next president takes office.

View the Lab's full agenda [here](#). For more information, please contact Glenn Yago at gyago@milkeninstitute.org.

On October 2, the Milken Institute hosted a Forum in Santa Monica, "Demystifying the Mortgage Meltdown: What It Means for Main Street, Wall Street and the U.S. Financial System." Click [here](#) to read a summary or watch the video.

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