A discussion of: "Default, Mortgage Standards and Housing Liquidity"

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  4. market tightness, standards and default
- and introduces intuitively compelling sources of propagation of housing demand shocks

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Since this all seems so obvious . . .

- . . . Why aren't every housing models search models?
  1. Dynamic search models are hard
  2. Maybe easier models (=models with no search frictions) get us most of the way anyway

A formal defense of NS models

- "*The NS economy, of course, generates negative co-movements between LTVs and prices*"

A formal defense of NS models

- "*The NS economy, of course, generates negative co-movements between LTVs and prices*"
- True for the particular NS environment you write
- Much less clear to me in general

A toy model

- Two dates: 0 and 1, all households born with some endowment $a > 0$ at date 0
- Can buy at price p_1 or p_2 with $p_2 > p_1 > a$
- Everyone is risk-neutral
- Lender has a net opportunity cost of 0
- At date 1 houses sell for $\bar{p} > 0$ with probability π, nothing otherwise

Lending standards

- Lender breaks even in expected terms provided:

$$\begin{aligned} \pi \min\left(\bar{p}, (p_1 - a)R_1\right) &= p_1 - a \\ \pi \min\left(\bar{p}, (p_2 - a)R_2\right) &= p_2 - a \end{aligned}$$

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- Rates, when offered, are independent of size ...
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- Lending standards (=LTVs on the menu), leverage (=LTVs selected) and prices all increase with $\bar{p}$ and π

Intuition

- Lending standards are first and foremost a function of lenders' expectations over the life of the loan
- "All" you need to generate rising prices, more leverage and observably weaker lending standards is that lenders expect prices to be high in the future
- That doesn't seem like a bad story (both at origination and later)

Intuition

- Lending standards are first and foremost a function of lenders' expectations over the life of the loan
- "All" you need to generate rising prices, more leverage and observably weaker lending standards is that lenders expect prices to be high in the future
- That doesn't seem like a bad story (both at origination and later)
- What's search got to do with it?

This model's mechanism

- Tight markets mean higher prices and higher likelihood of selling quickly and well $\rightarrow$ high LTV at origination

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- High LTV owners post higher prices since only then do they care about selling or not

What search buys you

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- Propagation!

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- Tightness is persistent

This paper vs. Hedlund (2015a and b)

- Housing supply is less elastic in this model
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Figure 10: Impulse responses to a positive income shock: matching

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level.

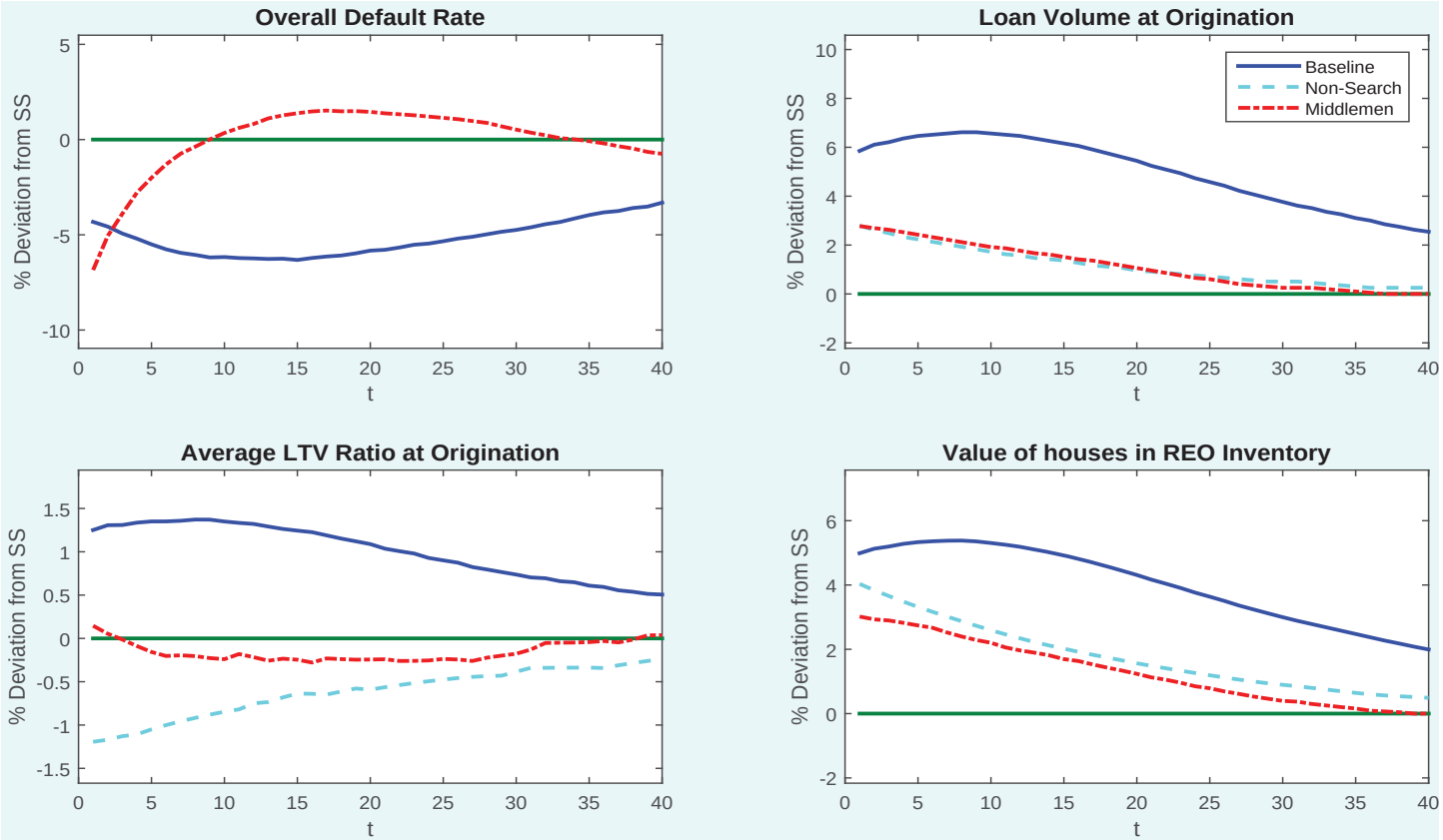

Figure 11: Impulse responses to a positive income shock: mortgage

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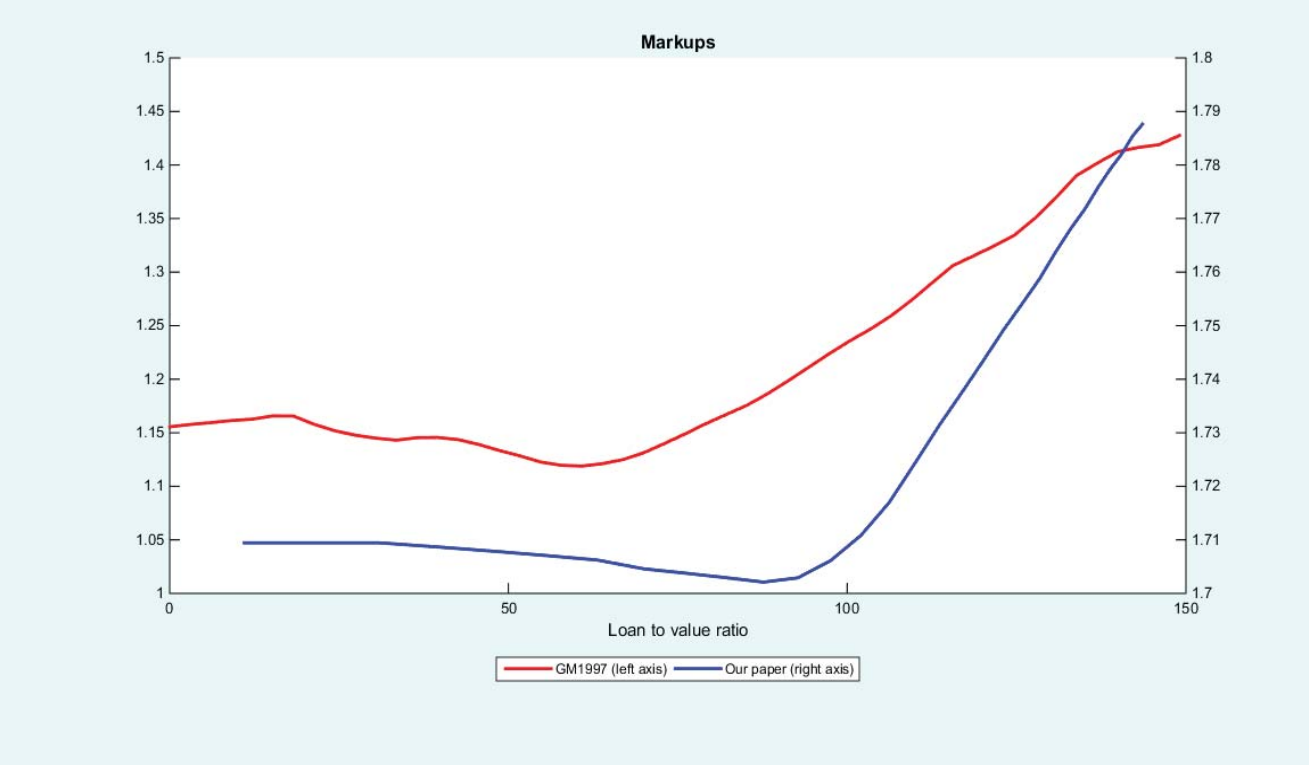

Mortgage pricing

- A model of housing default must take mortgage pricing seriously
- Here, mortgage size is independent of transaction price
- And rates are independent of LTVs and household characteristics

Summary of main suggestions

1. Give NS models a bit more respect
2. Establish more data benchmarks
3. Price mortgages properly

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Bottom line: a tremendous addition to a literature that constitutes clear progress towards better macro-housing models