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Securitization: Cause or Remedy of the Financial Crisis?

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Adam J. Levitin (https://papers.ssrn.com/sol3/cf_dev/AbsByAuth.cfm?per_id=450592)

Georgetown University Law Center

Andrey D. Pavlov (https://papers.ssrn.com/sol3/cf_dev/AbsByAuth.cfm?per_id=327180)

Simon Fraser University (SFU) - Finance Area

Susan M. Wachter (https://papers.ssrn.com/sol3/cf_dev/AbsByAuth.cfm?per_id=58534)

University of Pennsylvania - Wharton School, Department of Real Estate ; University of Pennsylvania - Finance Department

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Abstract

This article describes the causes of the boom and bust in the U.S. housing market, which brought down not just the U.S. financial system but the global economy. How did this vicious cycle begin? How did home prices appreciate so far and so fast? Why did rational investors not recognize and stop mispricing and investing in these loans on Wall Street? We offer a supply-side explanation of the mortgage crisis. At the root of the crisis was a new class of specialized mortgage lenders and securitizers unrestricted by regulations governing traditional lending and securitization. Eager to take profits in an originate-to-distribute lending model, aggressive lenders piled in by offering loans with low upfront costs, attracting first-time home buyers previously unable to afford houses, repeat buyers buying pricier homes and second homes, as well as speculators. These practices drove prices particularly high in Arizona, California, Florida, and Nevada, which had significant land-use regulations and environmental controls that reduced supply elasticity, leading increases in demand to trigger mostly higher prices instead of a greater supply of housing.

Keywords: securitization, mortgages, subprime, bubble, housing finance, MBS, mortgage-backed securities, credit default swaps, mispricing**JEL Classification:** G21, K20, G24[Suggested Citation](#) >[Show Contact Information](#) >

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