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From the Subprime to the Exotic: Excessive Mortgage Market Risk and Foreclosures

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Results and conclusions: Numbers of subprime, exotic, and zero-down-payment mortgages have all been growing. Where they are spatially concentrated they are linked to rising and geographically concentrated home mortgage foreclosures. I find evidence that subprime lenders achieve greater market penetration in metropolitan areas with less educated residents, and that higher-risk lending is more prevalent where housing prices are high and increasing. I also find that when local housing markets are hot, even high levels of subprime lending are associated with only slightly higher foreclosure filing rates, but foreclosure rates rise quickly when hot markets cool.

Takeaway for practice: Although foreclosures are less likely to be a severe problem in very strong real estate markets, when prices in previously hot markets stagnate or decline, foreclosures can quickly follow. This is a serious concern given recent trends in mortgage financing that have extended credit to more economically vulnerable populations and generally weakening housing markets in many metropolitan areas. These foreclosures tend also to be spatially concentrated within metropolitan areas, particularly stressing housing markets in neighborhoods where the higher-risk products are more prevalent. I recommend that planners: (1) track local lending and foreclosure patterns; (2) promote healthier mortgage markets in vulnerable areas; (3) fund targeted foreclosure prevention and counseling; (4) develop refinancing/restructuring programs; (5) redesign programs to promote sustainable homeownership; (6) get foreclose sure surges on renta g regulation and fore

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policymakers have historically paid little attention to housing finance. This article examines how changes in mortgage markets since the middle 1990s led to a dramatic widening of the risk spectrum of mortgage products and to problems of increased and geographically concentrated foreclosures.

Though nationally diversified bond and securities markets tolerated high levels of aggregate risk until late 2006, and the problem of excessive risk in U.S.mortgage markets became front-page news only in 2007, by that time many communities around the country had already been dealing with the problems of increasing and concentrated foreclosures for several years. National awareness increased when housing markets in California, Florida, and the Northeast that had been experiencing high rates of appreciation began slowing in 2006, and local foreclosure rates in these places increased dramatically, pushing up national levels of foreclosures. This devalued the securities backed by deteriorating subprime and alternative mortgages. Moreover, as adjustable rate loans with initially low, teaser [1] interest rates began resetting to higher levels, many markets that had already reached high levels of foreclosures experienced even greater problems.

This article begins by examining how changes in mortgage markets since the middle 1990s led to huge growth in high-risk loan products. I consider the recent rapid growth of three types of home purchase mortgage products:

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2. Exotic tive amorti subprime loans i e made at prime
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the down payment as a grant to the homebuyer. A zero-down-payment mortgage may be priced as prime or subprime, and may contain exotic features.

I examine patterns in where these products were sold, and conclude that, particularly where such lending is spatially concentrated, it is linked to rising and geographically concentrated home mortgage foreclosures, with serious negative impacts on neighborhoods and urban areas. This should be of particular concern to planners, as concentrated foreclosures create substantial negative impacts: abandoned property, crime, public safety costs, and reduced property values (Apgar & Duda, 2005; Immergluck & Smith, 2006). I conclude with what local planners can do to reduce the negative effects of these national trends on their own communities.

Growth in High-Risk Home Purchase Loans

Since the early 1990s, subprime mortgages have grown dramatically. The industry publication Inside Mortgage Finance calculates that subprime lending grew from approximately $35 billion in 1994 to $665 billion in 2005(Schloemer, Li, Ernst, & Keest, 2006). I focus only on home purchase loans in this article. While much of this growth was in the refinance sector in the earlier years, subprime loans were a substantial share of the ho stituted more tha share of refinanc bprime share of es in the composi ent share of purchas [FHA]) has declined re from the FHA p , subprime forec

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the growth in subprime purchase lending from 1997 to 2003 in 103 U.S. metropolitan areas with populations of at least 500,000 in 2000, shows that it grew considerably more in some places than others. Many California metropolitan areas, for example, experienced very large increases.

To better understand why the increases were greater in some metropolitan areas, and thereby suggest which factors might be most closely related to a region's mortgage risk profile, I used a regression model to estimate the shares of home purchase loans that were subprime inthese metropolitan areas in 2003. I controlled fortheir shares of home purchase loans that were subprimein 1997, and for the other demographic and housing stock characteristics likely to affect their subprime shares. These include: the size of the median purchase loan, the proportion of buyers who were Black, the proportion of buyers who were Hispanic, the proportion of residents who had atleast a college degree (hereafter called educational attainment), the proportion of housing units over 50 years old, the ratio of the FHA loan limit to the median loan amount, the ratio of median borrower income to median loan size, and the unemployment rate.[3] I alsoincluded 1997 to 2003 changes in median loan size, the racial and ethnic composition of buyers, and the unemployment rate as explanatory variables. These variables generally reflect the factors that are expected to impact loan risk or the demand or supply of subprime versus prime loans.For example, race has been shown to be a significant factor in whether me loan (Gruenst somewhat endoger

Figure 1. ranteed and subprim 93–2003: Source: y author using Fe 7–2004.

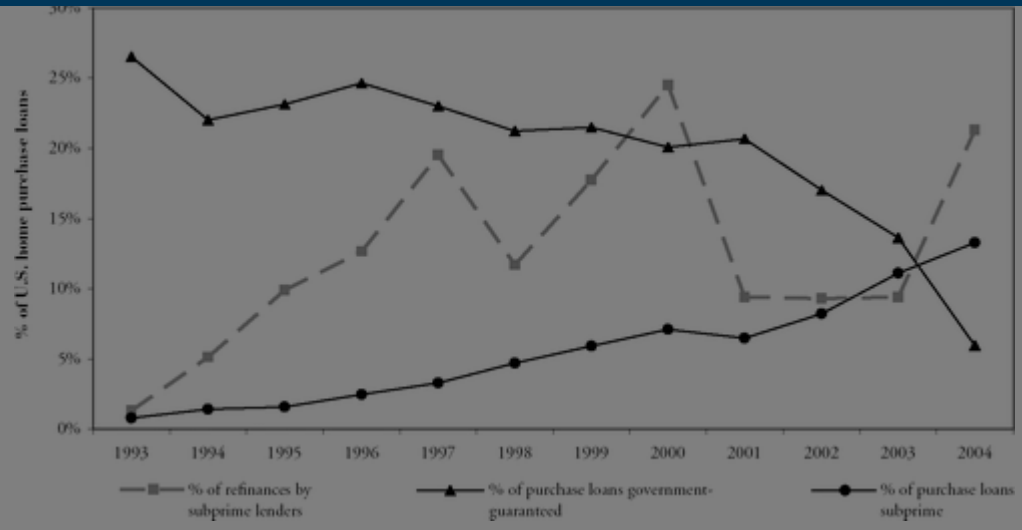

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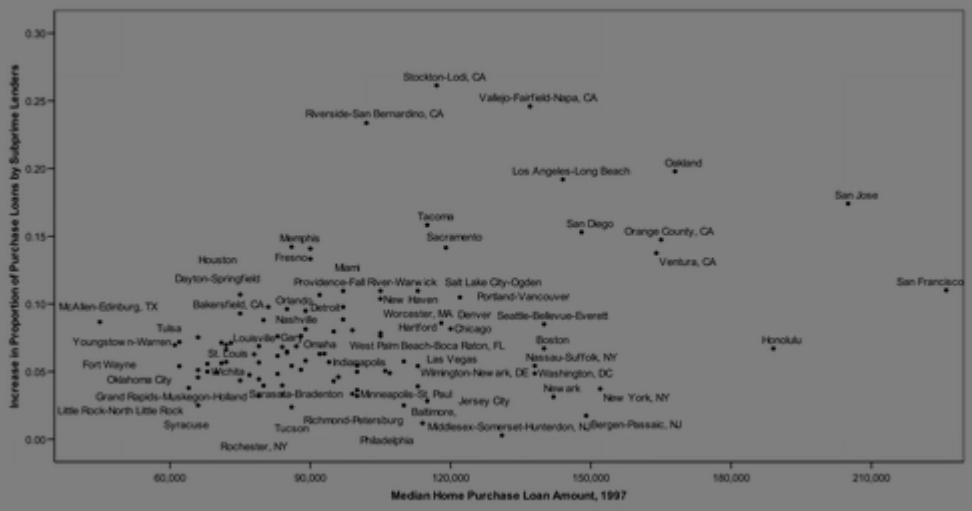
Table 1 provides the results of the second stage of my model. The signs of most coefficients are generally as I expected, with positive coefficients on Black and Hispanic buyer shares, older housing units, unemployment rate, change in unemployment, ratio of loan size to FHA limit, change in median loan size, and 1997 subprime share. However, with the exception of the 1997 subprime share and change in median loan size, these variables are not significant at conventional levels.[5] The most striking findings from Table 1 are those regarding educational attainment and the income-to-loan-size ratio. Higher educational attainment is negatively related to the growth of subprime share in a statistically significant way. A one-standard-deviation increase in educatic t a college educatic sociated with a d (with a mean of 11.1% by Hershaff, Wachter ter penetrat growth in subprim cts to less sophi

The rela 003 subprim subprime purchase er leverage rates ov alifornia, subprim be partly due to th in the next

risky mortgages because, as with their other products, they aim for higher profits to compensate for higher risks, and they have superior access to higher risk capital.

Figure 2. Increase in the subprime share of home purchase loans 1997–2003 versus median 1997 loan amounts, for 103 large U.S. metropolitan areas: Source: Author's calculations using HMDA data from Federal Financial Institutions Examination Council (2007).



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The growth in median loan size from 1997 to 2003 is statistically and positively related to subprime share in 2003. I expected this for two reasons. First, home values grew faster th homes, and demand loans at higher d nd loan sizes gre nsored Enterpri rs were not constrai risk capital, they we

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deregulation, the vertical disintegration of the mortgage industry (including the increase in third-party mortgage brokers and increased nonagency securitization[7] as a primary source of capital), the globalization of capital sources, and the specialization of lenders and investors (Fishbein & Woodall, 2006). Many of these same forces had previously spurred the growth of the subprime market (Wyly, Atia, & Hammel, 2004).

The available indicators show strong growth in exotic mortgages, especially from 2001 to 2005. LoanPerformance, Inc. tracks loans sold to third parties other than the GSEs Fannie Mae and Freddie Mac. While this leaves out a sizeable segment of the overall mortgage market, it likely includes a large portion of the growth in exotic loans.

Table 1. Results of model predicting share of 2003 home purchase loans made by subprime lenders in U.S. metropolitan areas with populations over 500,000 in 2000.

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These data show that among tracked loans, those that were interest-only rose from under 5% in 2001 to approximately 35% in 2005 (LoanPerformance, 2006). Negative amortization loans rose from less than 1% in 2003 to more than 7% by 2005. In California, this figure topped 17% in 2005. LoanPerformance also listed 12 metropolitan areas in ed for more than 50%

Many, if cially those made be tially low interest ortgages (ARMs) a ributing to their erest-only loans he increase in ARM a

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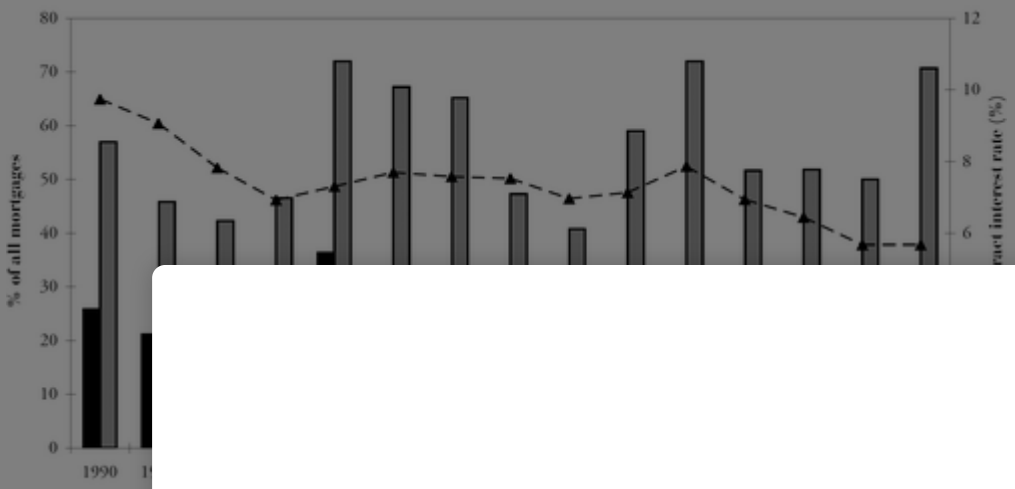
figure distinguishes between jumbo and non-jumbo loans. Figure 3 shows that the share of mortgages that are ARMs fluctuates widely. Traditionally, as rates for fixed-rate loans fall, the short-term savings that ARMs can provide decline, and fixed-rate loans increase. This was the case from 1990 to 1992. As rates rose from 1998 to 2000, ARMs increased as expected. However, the expected pattern was disrupted thereafter, suggesting that the greater number of ARMs was driven by something other than prevailing fixed interest rates. From 2001 to 2003 interest rates generally fell and ARMs held steady for jumbo loans and increased for non-jumbo mortgages. Then, although rates remained relatively flat, ARMs increased dramatically in 2004, making up 71% of jumbo loans and 31% of non-jumbo loans according to the MIRS data. Even so, these data likely understate ARM growth in later years, especially in the subprime market and for loans with teaser introductory rates.[8]

Figure 3. Percentage of conventional jumbo and non-jumbo mortgages with adjustable rates, 1990–2004: Source: Federal Housing Finance Board (2006).



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they and/or the investors in their mortgage-backed securities were confident that properties would appreciate sufficiently to cover any losses. Moreover, in higher-priced markets, the profits made off the larger loans were expected to be large enough to compensate for anticipated future losses.

Growing Numbers of Zero-Down-Payment Loans

During much of the 20th century, the standard down-payment requirement for a home purchase loan was 20%. Until the 1990s, down payments below 20% typically required either private mortgage insurance or the use of a government-insured or government-guaranteed loan. Some buyers receive seller-funded down-payment assistance. Public and nonprofit entities sponsor zero-down-payment loan programs to subsidize homeownership. The Veterans Administration introduced a zero-down-payment loan program as early as 1944 (Government Accountability Office, 2005a). The FHA followed with a program permitting down payments of 5% in 1948 and then 3% in 1957. In the 1970s, the GSEs began purchasing loans on which the homeowner had put as little as 5% down. In 1994, Fannie Mae introduced a 3% down product, and Freddie Mac followed with a similar product in 1998. In 2000, both GSEs began offering products that required no down payment. While both GSEs continue to offer products requiring down pa FHA remains a smalle ans had loan-to-v lae and Freddie Office, 2005a).

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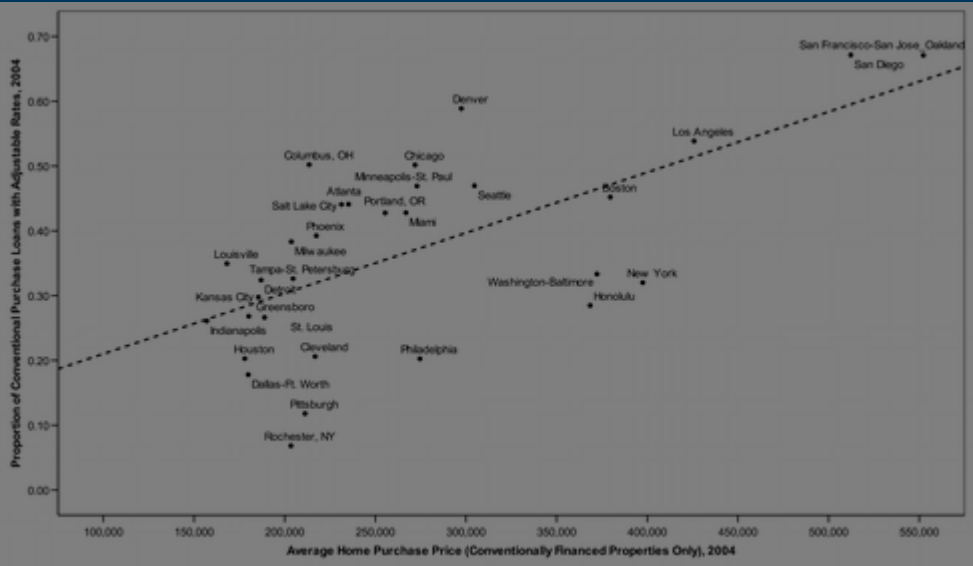

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According to my calculations using microdata from the 1999 American Housing Survey (AHS), only 5% of owner-occupiers purchasing single-family homes in MSAs (metropolitan statistical areas) in 1998 and 1999 indicated “no down payment” when asked what their main source of the down payment was for their house, but the 2005 AHS data show this figure had reached 13.3% for 2004 and 2005 (U.S. Census Bureau, 1999, 2005). Given that many zero-down-payment programs are aimed at lower-income borrowers, these products are likely to be more concentrated than this in modest-income neighborhoods.

From 20 er than 95% and invo ernment Accounta s involving down-pa 0%. Many lenders irst-time homebu not come from an traditionally has a ty (often a develop to the buyer. [11]

Trends

Although the expanding availability of subprime, exotic, and zero-down-payment loans has undoubtedly brought benefits to some individual homebuyers, for others it has brought severe financial hardship in the form of foreclosure. I will not analyze the benefits and costs to individuals here. Instead, I focus on the social costs of these trends as higher and often geographically concentrated foreclosure rates harm neighborhoods and cities. Subprime lending has been the biggest contributor to foreclosures thus far, though exotic mortgages and zero-down-payment mortgages have played roles as well.

Subprime Mortgages and Foreclosures

A substantial body of research points to widespread problems in the subprime market. There is evidence that minority households are more likely to receive subprime mortgages even after controlling for credit quality, and that abusive lending practices have been concentrated in the subprime sector (Gruenstein-Bocian et al., 2006; Nichols, Pennington-Cross & Yezer, 2005; U.S. Department of the Treasury & U.S. Department of Housing & Urban Development [HUD] 2000). However, my main concern is that subprime mortgages have been associated with large, spatially concentrated increases in foreclosures (Apgar & Duda, 2004; Immergluck & Smith, 2005). For the first three qu d States were sub 13% of outstand

A numbe me loans compare erg, 2005; Immergl t al., 2006). Gener se at rates betw osures and subprim osure rates of subpr et al. (2006) found th vice as likely to go int us, while subprim hase loans are gene

The foreclosure rate of subprime loans has also been worsening. Recent data show that subprime mortgages made in 2006, at the peak of the subprime boom, were likely to go into default and foreclosure substantially sooner than loans made in earlier years (Standard and Poors, 2007). Industry research suggests that overall subprime mortgage default rates doubled between 2004 and 2006, and that loans originated in 2006 were of substantially higher risk than loans originated in earlier years (AEW Research, 2007).

The relationship between subprime purchase lending and foreclosure rates depends on the strength of the local housing market. Because homeowners having difficulty paying their loans in hot housing markets can more easily sell or refinance into more affordable mortgages, I expect foreclosure rates to be lower in such markets, and the available data support this. RealtyTrac, Inc. compiles data on foreclosures[12] for 100 large metropolitan areas, the data for 81 of which are comparable to those for the 103 metropolitan areas I analyzed previously. To estimate a foreclosure filing rate in each of these 81 metropolitan areas, I divided first quarter 2006 foreclosure filings from the RealtyTrac report by the number of home purchase and refinance loans originated in the metro area in 2003 as measured by Home Mortgage Disclosure Act (HMDA) data. Figure 5 plots my estimated metropolitan foreclosure filing rates against the shares of home purchase loans made by subprime lenders in the same metropolitan areas in 2003. As predicted, it indicates that when local housing markets are hot, even high levels of re filing rates. In ng are associat as within the dott at in this group of ry high subprim For metropo and for which eeper, indic with high foreclosu

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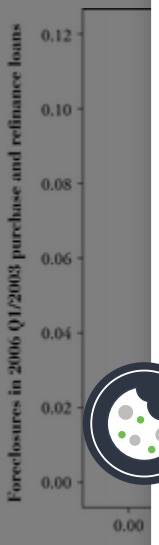
Although foreclosures are rarely a severe problem in hot real estate markets, as prices in these areas stagnate or decline, foreclosures can quickly follow. The accelerating problem of subprime foreclosures in 2007 has demonstrated how very strong housing markets in several large regional housing markets propped up the loan performance of nationally diversified subprime lenders and of the securities backed by their loans. When large parts of the country experienced strong housing price appreciation, subprime borrowers in these markets were able to sell their homes or refinance into new loans if they had trouble meeting their loan payments when their adjustable rates increased. Loan performance in many weaker markets was already fairly poor, but aggregate national losses were not too far from what investors had generally expected. However, when values stalled and foreclosures increased in large markets that had been experiencing very strong price growth, such as Florida, California, and the Northeast, loss rates began to exceed what securitization models had accounted for, and they did so quite rapidly.

Figure 5. Foreclosure filing rates versus subprime lender shares of home purchase loans for 81 large U.S. metropolitan areas: Sources: Foreclosure filing rate calculated by the author using data from RealtyTrac, Inc. (2006) and HMDA data from Federal Financial Institutions Examination Council (2007). Share of home purchaseloans that were subprime calculated by the author using HMDA data from Federal Financial Institutions Examina



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over this period, with increases of at least 20 percentage points in 65 of them. After excluding metropolitan areas with fewer than 1,000 foreclosures in the second half of 2006, Table 2 lists the 20 metropolitan areas for which filings increased by the greatest and smallest percentages between the last half of 2006 and the first half of 2007, a period of rapid deterioration in the subprime mortgage market. Of the 20 metropolitan areas with the largest increases in foreclosures, eight are in California and 5 are in the Northeast. Also on the list are Washington DC, Phoenix, and Las Vegas. These are housing markets in which home prices had been appreciating rapidly until approximately 2006. The metropolitan areas whose foreclosures declined or rose only slightly had smaller subprime shares and in general had been experiencing relatively modest levels of appreciation in recent years.

Spatially concentrated subprime loans can result in poor outcomes for neighborhoods and local governments. A number of studies have shown a disproportionate share of metropolitan foreclosures and increases in foreclosures in recent years to be in lower-income and minority neighborhoods (for a review, see Apgar & Duda, 2004). A study of foreclosures in Atlanta found predominantly minority census tracts had foreclosure rates (as measured by foreclosures per mortgaged unit) approximately 12 times those of predominantly White tracts (Apgar & Duda, 2005). These tracts also had the highest concentrations of subprime mortgages. Figure 6 shows that in Cook County, Illinois, foreclosu n in more distant s foreclosu census tracts in dominantly minority efinance loans to lling for a variety c

Because many exotic mortgage products involve some version of adjustable interest rates or changing amortization schedules, as well as introductory teaser rates, the risks that borrowers face due to changing mortgage payments can be quite substantial. Although their study looked only at subprime loans, Schloemer et al. (2006) found that, other things equal, loans with adjustable rates are more than twice as likely to default as fixed-rate loans. Cagan (2007) projected that 32% of ARMs with teaser rates and 7% of market-rate ARMs will default due to interest rate resets.[14]

Industry analysts have estimated that as much as $1 trillion in ARMs were subject to resetting interest rates in 2007, up from less than $400 billion in 2006 and $100 billion in 2005 (Frantantoni, 2005). While many of the resets in 2006 and 2007 affected subprime loans, many exotic mortgages have longer initial interest rate periods, meaning that those originated in 2003 through 2005 will reset in 2008 and beyond.

As is the case with subprime loans, one of the key risks for areas with many exotic mortgages is the cooling of hot housing markets. Where exotic mortgages are concentrated in markets likely to lose value, there is a risk of acceleratingforeclosures once homeowners can no longer sell or refinance easily. Cagan (2007) found that for ARMs originated in 2006, 23.9% of properties had negative equity (the home's value was less than the mortgage amount), up from only 7.6% in 2004, and compared to only 10.3% of fixed-rate borrowers. Moreover, if prices were to fall by 10%, 48.9% of the adjustab Therefore I expect n have high ARM sha

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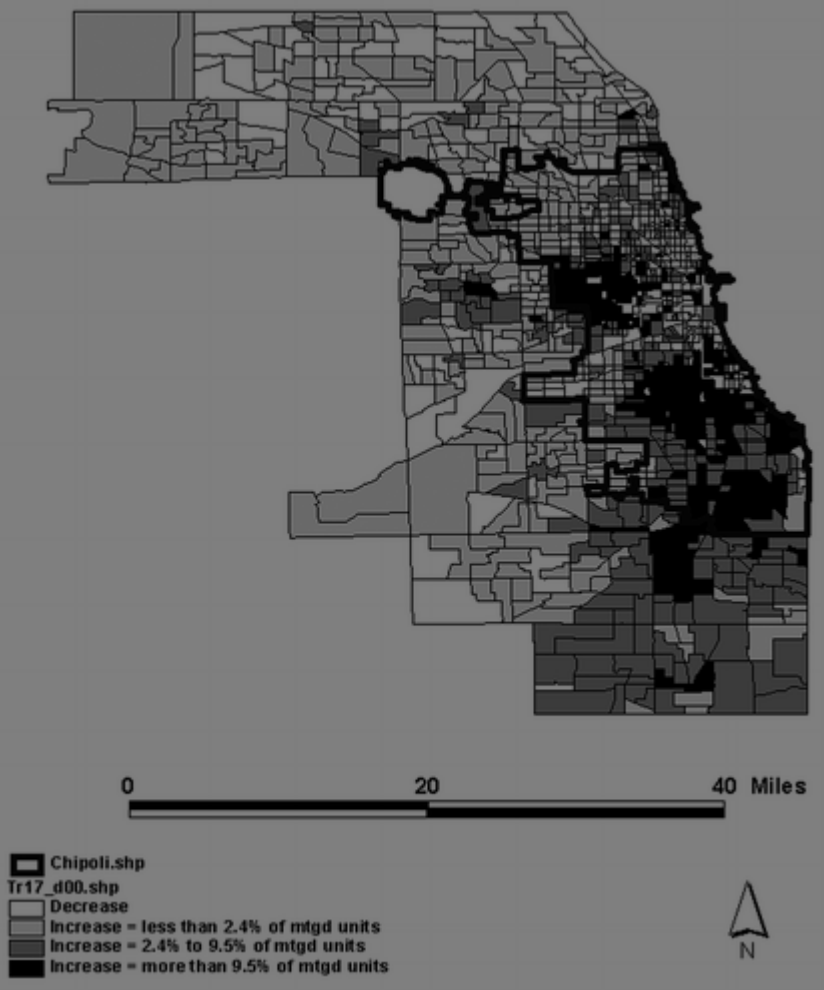

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The private mortgage insurer PMI, Inc. has developed a market risk index which is intended t two years (PMI, Inc RS data on the shar ng Finance Board, 2 one with market r he higher-risk met -risk cluster, a higher

Fore first half of 2007 ve increased by much borrowers are likely Moreover, both hig rd pressure on housi ntageous for individua

One type of alternative mortgage is the stated-income loan, in which lenders require little to no documentation to verify borrowers' incomes. This segment of the home purchase loan market grew rapidly from 2000 to 2006, accounting for approximately 18% of all mortgage originations by 2006 (Bajaj, 2007). There is some evidence many people obtaining such loans claimed incomes that were substantially higher than they actually received. The Mortgage Asset Research Institute, a firm that tracks mortgage fraud, reported that in a sample of 100 stated income loans for which it obtained borrowers' IRS forms, 90% had exaggerated their incomes by 5% or more, and almost 60% had exaggerated their incomes by more than 50% (Sharick, Omba, Larson, & Croft, 2006).

Zero-Down-Payment Mortgages and Foreclosures

The growth of zero-down-payment mortgages has also had implications for foreclosures. Evidence suggests that without a homebuyer counseling component, very-low-down-payment lending may lead to higher default and foreclosure rates, imposing significant costs on households and communities. The literature on mortgage defaults has generally found that very high LTVs increase default rates substantially (Deng, Quigley, & Van Order, 1995; Government Accountability Office, 2005a.)
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“FHA reform” advocated enabling more zero-down-payment activity in FHA products to address the problems in the subprime market, though critics argued the proposed changes would repeat past mistakes (Donahue, 2007).

Implications for Local Planning and Policy

The recent changes in mortgage markets I have described here have had four consequences. They have: 1) increased the overall level of risk in the mortgage market; 2) shifted more risk from lenders to borrowers by increasing the use of adjustable rate and other alternative loan structures; 3) increased the vulnerability of metropolitan housing markets to plateaus in home price appreciation, so that when a rapidly appreciating regional housing market begins to appreciate more slowly foreclosure rates increase substantially; and 4) resulted in spatially concentrated patterns of foreclosures, particularly stressing housing markets in neighborhoods where the higher-risk products are more prevalent. Moreover, because foreclosures both increase available housing stock and remove households from the homeownership market at least temporarily, higher numbers of foreclosures and stalling or declining home values can become mutually reinforcing trends.

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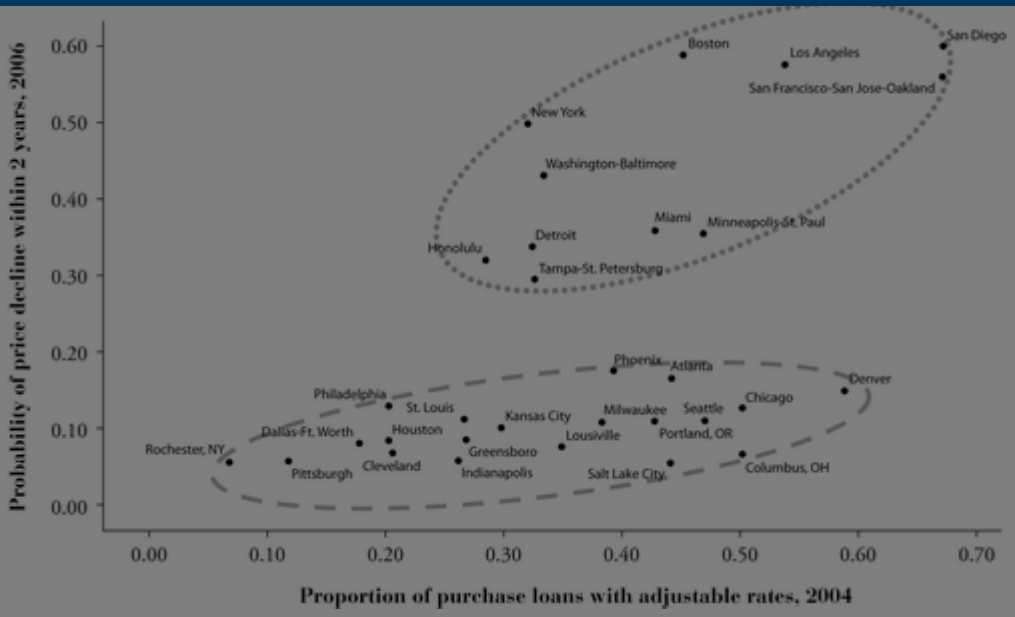
Figure 7. metro markets 6).



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Although local action can be overwhelmed by the impacts of unwise federal or state policy, I recommend seven things that planners can do in their own localities to address the problems higher-risk mortgage lending can bring.

Track Local Lending and Foreclosure Patterns

Planners should routinely map local lending patterns using readily available HMDA data. For exan ans made in each cer alternati A. Planners can also g groups consider lanners should a rging. In some ar a vendors, while sure data and ma e digitized format.[1]

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Some communities have developed “neighborhood early warning systems” that alert planners, community groups and officials to signs of increased housing problems, including foreclosures, code violations, and tax delinquencies, so they can take action before problems grow too large. The Providence Urban Land Reform Initiative, a joint effort of the Providence Plan (2006) and the Providence Department of Planning, is an excellent example of such an effort.

Promote Healthier Mortgage Markets in Vulnerable Areas

Planners should proactively encourage responsible lenders to market their products more aggressively to areas that have been dominated by subprime lenders, and to monitor their own loan officers and the independent mortgage brokers with whom they work for abusive or questionable lending practices. While it may be unwise for some subprime borrowers to refinance, research suggests that many are creditworthy and can be served with better structured, more responsible, and less expensive products (An & Bostic, 2006; White, 2004). The federal Community Reinvestment Act (CRA) encourages banks to meet the credit needs of their communities, and can be a tool for promoting sound and fair lending, though unfortunately local governments have made little use of it. For example, planners may comment formally to federal regulators under the CRA rticular commur ending practice

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any abusive features of the loan, providing the borrower with much more negotiating power.

Develop Refinancing/Restructuring Programs

In localities with neighborhoods that have very high foreclosure rates, state and local agencies should work to develop programs to restructure loans for large numbers of distressed borrowers. Such programs should aim to reduce mortgage payments and to maintain these reduced payments over the (potentially extended) term of the loan. Two basic strategies can be employed in tandem. First, local and state planners and officials can work with major servicers and mortgagees in their localities to negotiate processes through which borrowers can more easily obtain affordable loan modifications, including term extensions, rate reductions, and temporary forbearance packages. Individual borrowers can be intimidated by large, sometimes complex, loan servicing operations. They may have difficulty reaching the right individuals, and may generally lack the skill to negotiate with personnel at the servicing firm. Illinois, New York, Massachusetts, and Ohio have formed task forces or initiated discussions involving local housing groups and representatives of the lending and investment industries on how to improve distressed borrowers' chances of obtaining restructured loans to avoid foreclosu

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initiated programs to provide refinance or bridge loans of some sort to distressed borrowers (Krauss, 2007). However, these programs are not large enough to help more than a few of the borrowers needing assistance. For example, Massachusetts' program is funded at $250 million, and estimated sufficient to assist approximately 1,000 homeowners. Moreover, if the funding sources and state administrations have low tolerances for risk, the proportion of distressed borrowers able to qualify for such programs may be quite modest.

Redesign Programs to Promote Sustainable Homeownership

Most metropolitan areas have homeownership financing programs supported by federal, state, and local government (Galster & Santiago, 2007). Reactions by some segments of the credit markets to recent developments may reduce liquidity so much that even applicants with only slightly impaired credit histories will be unable to obtain affordable and soundly structured home loans. In such an event, it will be especially important for the public sector to maintain a role in homeownership financing programs for low- and moderate-income residents. However, planners should work to ensure that such programs are well designed and managed, and aim to promote sustainable homeownership, not homeownership that ends in foreclosure. Planners should advocate screenin usive lending practices ir existing lending ure preventi

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lenders to give the lenders alternatives to abandoning properties on which they have foreclosed.

Recognize the Effect of Foreclosure Surges on Rental Housing Markets

As substantial numbers of homeowners exit the owner-occupied segment of the local housing market at least temporarily through the foreclosure process, this will put demand-side pressures on rental housing in a region. Thus, planners should prepare for the rising demand for rental housing in markets suffering from large increases in foreclosures. Moreover, because foreclosure has a serious negative impact on an individual's credit history, it can also put affected households at a substantial disadvantage in the rental market, as many landlords screen out prospective tenants with weak credit histories. Thus, the selection of housing stock and neighborhoods for foreclosed families may be significantly limited.

Be Proactive in Policy Debates on Lending Regulation and Foreclosure Processes

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The recent contraction in high-risk lending is likely to be temporary. The subprime market went through a less severe decline after the Asian financial crisis of 1998, only to roar back to become larger than ever. Unless we change federal and state lending policies to reduce the effects of future wide swings in liquidity on lending standards and eventually on foreclosures, mortgage markets are likely to exhibit booms and busts like the most recent cycle. Such a volatile system of housing finance creates many challenges for local communities and planners, including, in the most recent cycle, local foreclosure crises in hundreds of neighborhoods across the country. Planners should learn how the new housing finance affects their communities, and develop analytical, planning, and policy strategies and tools to anticipate the next challenge and respond more effectively to the next mortgage market crisis.

Notes

Note: a. Based on 79 of the 100 metropolitan areas ranked by RealtyTrac. Excludes 21 metro areas with fewer than 1,000 filings in the last 6 months of 2006.

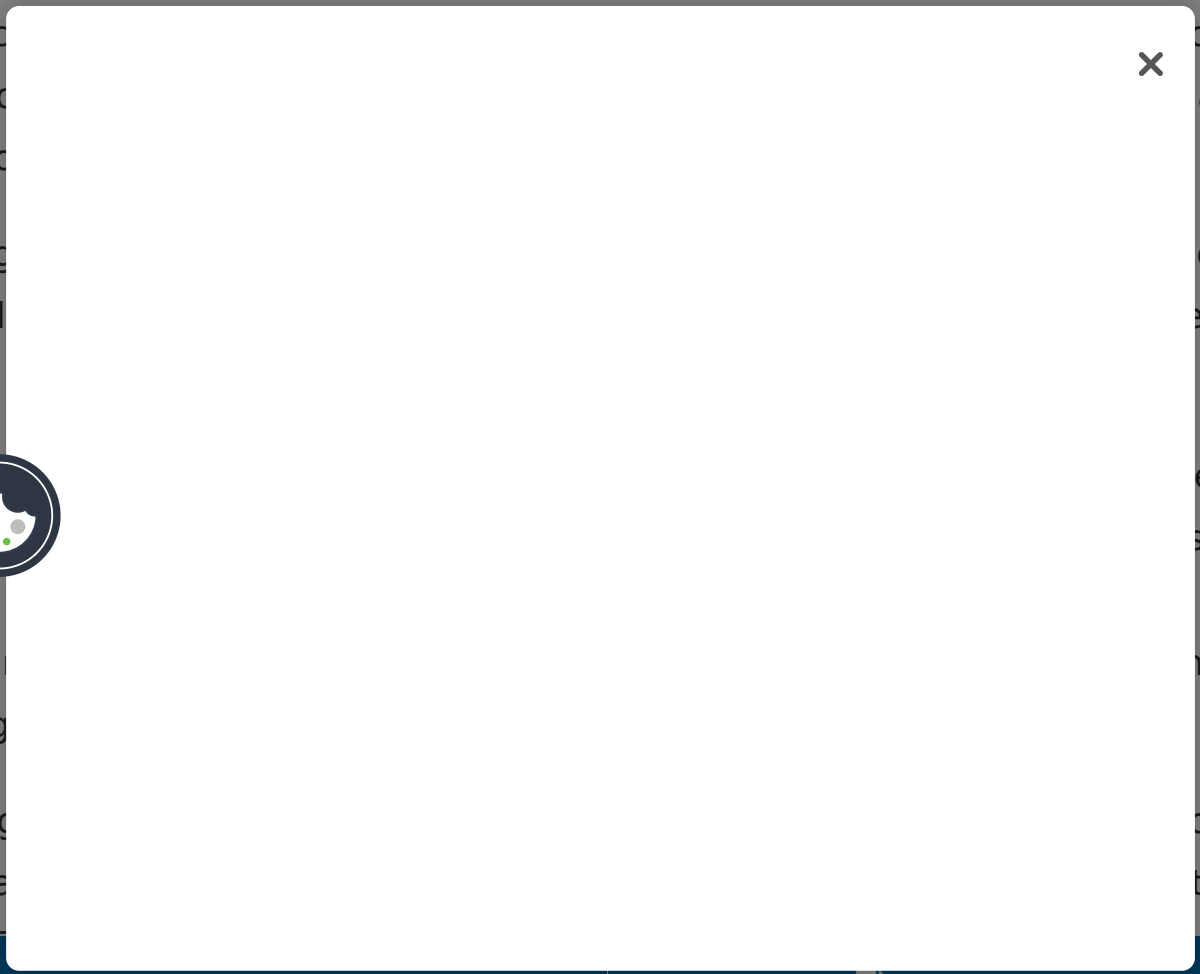
Source: RealtyTrac, Inc. (2006).

1. Teaser rates are initial interest rates that typically run for between 1 and 5 years and are signi ctured loans.

2. In mo ayments (no princ ose for which th only, or some mi gative amort on the loan, and s mortgages that allo rivate mortgag st rate. Alt-A loans ar mium in exchang r income. For a mo lall (2006).

3. I added the square of the income-to-loan-size ratio after diagnostic plots indicated a nonlinear effect.

4. The change in the proportion of buyers who were Black, the change in the proportion of buyers who were Hispanic, and the change in median loan size, may result from as well as cause changes in the share of a metropolitan area's home purchase loans that are subprime, making these variables potentially endogenous. First, an increased presence of subprime lenders in a region may be expected to increase the number of Black or Hispanic homebuyers, due to their providing more access to credit for Black and Hispanic households than prime lenders. Second, more subprime lending may actually increase the prices of homes by providing borrowers with greater spending power (through higher debtto- income ratios), which in turn can result in a bidding up of housing values. To remedy this, I used a two-stage least-squares technique, first regressing these three endogenous variables on the other independent variables together with three additional instrumental variables I expected to affect the three endogenous variables but not to be significantly affected by the dependent variable. For instrumental variables, I used the 1997 to 2003 change in the metropolitan area's home price index as measured by the Office of Federal Housing Enterprise and Oversight; the change in the proportion of the population that was African American from 1990 to 2000; and the change in the proportion of the population that was Hispanic



d values of the endo ated the main mo

5. Thoug gnificant at the .10 l ed size of my sample.

6. Fan es, with signi s to low-interest it markets). They pu nd issue mortgag

7. Nonag o create collatera than Fannie

8. The MIRS data omit some significant segments of the mortgage market, including refinance loans, very large loans, loans made by specialized subprime lenders, and in latter years, loans with interest rates below 2.75%, including many ARMs with teaser rates (Congressional Budget Office, 2001). This last omission is particularly relevant in recent years with the advent of exotic mortgages and given the relatively low interest rate environment.

9. Even some public agencies have promoted exotic products as a means of enabling buyers to purchase larger homes. For example, Rhode Island Housing, a public lender, promoted its “Buy More” program as enabling the borrower to qualify “to buy a bigger house, a house in better condition or a house in a more convenient location.” The product is an interest-only loan (Rhode Island Housing, 2006).

10. The maximum LTV ratio on FHA loans varies, but is technically capped at just under 98%. However, some costs and the FHA up-front insurance premium are excluded from this calculation, so that the LTV can effectively exceed 100% on some loans (Berkovec, Canner, Gabriel, & Hannon, 1994.)

11. In 2006, however, the Internal Revenue Service ruled that organizations providing seller-funded assistance do not qualify as tax-exempt charities. The Sacramento-based Nehemiah Corporation of America, the largest of such organizations, is appealing the ruling (W

12. Real
preforec roperties,
with mo rated the
fourth la es properties
in all thr tate-owned
(REO) pr ort,
there of the
foreclos large
number

13. This es such as
the FHA

14. Neith

15. Making real estate data generally available does raise privacy concerns. However, I generally advocate that regional planning bodies collect and disseminate only what is already part of the public record, providing it to the public at little or no cost. In most areas data firms already provide such a service, but charge high prices, meaning mortgage brokers and property investors are effectively the only parties able to afford access to these data.

16. Note that some of the recent reforms, particularly those proposed for the Federal Housing Administration, were designed long before the subprime mortgage crisis and are intended mainly to reverse the decline in the FHA's share of the mortgage market.

17. Mortgage lending and foreclosure policy at the state and federal level is a complex topic beyond the scope of this article. For recommendations aimed at improving access to sound and responsible credit and at reducing high and spatially concentrated foreclosures, see Immergluck (2004) and Schloemer et al. (2006).

The external costs of foreclosure: The impact of single-family mortgage foreclosures on property values

Source: Housing Policy Debate

Mortgage Default and Low Downpayment Loans: The Costs of Public Subsidy

Source: Unknown Repository

The impact of predatory loan terms on subprime foreclosures: The special case of prepayment penalties and balloon payments

Source: Housing Policy Debate

A Dynamic Look at Subprime Loan Performance

Source: SSRN Electronic Journal

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