Introduction

Special issue on subprime mortgage lending

The recent rise in subprime mortgage default and declines in housing prices, particularly in “Sand States” such as California, Arizona, Nevada and Florida as well as Midwest cities such as Detroit, Cleveland and Chicago, has generated significant research interest into the root causes of the “subprime crisis”. Given the importance of the housing and mortgage markets to the economy, the Homer Hoyt Institute has sponsored this special issue of the Journal of Housing Economics on this timely and extremely important issue. The articles in this issue begin with more macro views of the subprime crisis and end with metropolitan and neighborhood studies.

The first article by Anthony B. Sanders entitled “The Subprime Crisis and its Role in the Financial Crisis” examines how rapidly subprime defaults increased as housing prices in California, Nevada and Arizona slowed and then declined. He argues that there was a fundamental paradigm shift in the relationship between housing prices and subprime defaults which would not have been captured by historically-based models of credit risk used by banks, investment banks, regulators and investors.

The second article by Richard Green entitled “Imperfect Information and the Housing Finance Crisis” argues the subprime crisis was, in part, caused market imperfections such as asymmetric information and adverse selection. For example, some mortgage brokers exploited asymmetries in compensation and information to extract rents while some borrowers adversely selected into loan products with advance knowledge that they would ruthlessly default.

The third article by Major Coleman, Michael Lacour-Little and Kerry Vandell entitled “Subprime Lending and the Housing Bubble: Tail Wags Dog?” examines the role that political and regulatory actions as well as economic conditions played in the disruption of traditional flows of credit into the market and the relative absence of the GSE’s during the period 2004–2006. The authors further argue that weaker underwriting standards flowed into the void created by this relative absence of the GSEs during this period.

The fourth article by Christopher L. Foote, Kristopher Gerardi, Lorenz Goote and Paul Willen entitled “Just the Facts: An Initial Analysis of the Subprime Crisis” presents a series of interesting facts about the subprime crisis including the view that the widespread decline in housing prices is the proximate cause of the current housing crisis. They also argue that there is evidence that higher housing prices caused many high-FICO borrowers to turn to the subprime market in order to purchase increasingly expensive homes.

The fifth and final article by Jenny Schuetz, Vicki Been and Ingrid Ellen entitled “Neighborhood Effects of Concentrated Mortgage Foreclosures” finds that properties in close proximity to foreclosures sell at discount. The magnitude of the price discount increases with the number of nearby foreclosure notices, but with some diminishing marginal impacts. The authors’ results also suggest that housing prices are significantly lower in neighborhoods in which foreclosures will occur, even before significant foreclosed activity.

Richard Green
University of Southern California, USA

Anthony B. Sanders
Arizona State University, USA
E-mail address: sanders.12@gmail.com

Susan Wachter
University of Pennsylvania, USA
E-mail address: wachter@wharton.edu

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