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Homer Hoyt Institute

www.hoyt.org

Subprime Crisis: National-State-Local Perspectives

**Subprime Crisis Research Council Symposium
2008 ARES Meetings, Captiva Island, Florida**

Susan Wachter (Weimer School Faculty) and John Weicher (Weimer School Faculty Emeritus) organized and co-chaired a well-attended special session on the subprime mortgage crisis April 17 at the 2008 American Real Estate Society (ARES) meetings. Wachter (University of Pennsylvania's Institute for Urban Research) and Weicher (Hudson Institute) are co-chairs of the Subprime Crisis Research Council Executive Committee, with members Richard Green (George Washington University), Robert Edelstein (U. California - Berkeley), Amy Crews Cutts (Freddie Mac) and Maury Seldin (Homer Hoyt Institute).

Providing the national perspective on the subprime crisis were panelists Marsha Courchane (Vice President, CRA International), **"The Subprime Mortgage Market: Implications and Outcomes"**; Amy Crews Cutts (Deputy Chief Economist, Freddie Mac), **"Interventions in Mortgage Default: Policies and Practices to Prevent Home Loss and Lower Costs"**; and Andrew Davidson (President, Andrew Davidson & Co., Inc.) **"Subprime Crisis: A Securitization Perspective."**

State and local perspectives were presented by Stephanie Casey Pierce (Policy Analyst, Center for Best Practices, National Governors Association), **"Emerging Trends in State Policy to Prevent Foreclosures"**; John Ryan (Executive Vice President, Conference of State Bank Supervisors), **"The Subprime Crisis: A State Perspective - State Mortgage Supervision Reform Initiatives/Mortgage Servicing"**; Tony Sanders (Professor of Finance & Real Estate, W.P. Carey College of Business, Arizona State University), and Jack Tatom (Director, Research Networks Financial Institute, Indiana State University), **"The Subprime Crisis: Evidence from a Leading Region and Comments on Monetary Policy."**

Panel members discussed many of the aspects of the subprime crisis. Subprime default and foreclosure experiences relative to prime mortgages were noted, with a marked increase in subprime defaults in 2006 and 2007. The subprime problem has been transmitted to global financial markets including the Swiss, Japan, United Kingdom, China and elsewhere. However, although the subprime crisis is affecting the level of house prices and the national economy in general, aggregate data can obscure the uneven impact across states and within a local housing market, where some neighborhoods and submarkets have been less affected.

Two panelists commented that subprime defaults and foreclosures will continue in 2009. (*Cont. on page 2*)

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Subprime Crisis: National-State-Local Perspectives
Subprime Crisis Research Council Symposium
2008 ARES Meetings, Captiva Island, Florida
(Cont. from page 1)

It was noted that borrowers have few additional resources to draw upon. Borrowers already have two-earner families, significant credit card debt, little or no savings, and have borrowed against equity, which may have been washed away by declining house prices. Further, the subprime problem is broadening to other classes of mortgages including Alt-A.

Legislators, federal and state regulators, and lenders have responded to a crisis where the entire mortgage lending process from the borrower through to the ultimate investor has been a system of "checks" only, with no "balances", creating a pro-cyclical system. A variety of remedial actions have been implemented or proposed. Borrowers are being encouraged to talk with their lenders about modification of terms. Early intervention in the borrower's difficulties is the key to success in a repayment plan. Loans modified after foreclosure referral experience a lower failure rate than loans not modified. The chances of borrowers to cure out of foreclosure would be enhanced if foreclosure timelines were shortened in states with lengthy timelines and lengthened in states with short timelines.

States are reaching out to at-risk borrowers, offering targeted assistance to help homeowners (financial

assistance, refinancing options, legal aid, counseling), cracking down on predatory lending and fraud, reevaluating the foreclosure process, and working to sustain neighborhoods. Several states have indicated an intent to participate in a proposed nationwide mortgage licensing system to create a single record for every state-licensed mortgage company, branch and individual to be shared by all participating states, and a single repository for all enforcement actions. Nontraditional and subprime guidance for state-supervised mortgage brokers and lenders have been adopted by several states, and model examination guidelines have been developed for use by state mortgage regulators for lenders and brokers offering subprime and nontraditional mortgages. A nationwide cooperative protocol and an agreement for mortgage supervision would deal with coordination and supervision of multistate mortgage entities and coordination among state mortgage regulators.

The subprime mortgage crisis is an extremely complex economic and regulatory problem that will continue to reverberate and generate palliatives and proposed solutions into the foreseeable future. The reader is referred to the Hoyt Group website (www.hoyt.org) for additional information.

Supporting the Subprime Crisis Research Program

Amy Crews Cutts has been appointed chair of a Subprime Crisis Research Committee on Expanding Programs. The committee is charged with development of resources in support of SCRC activities. Persons and organizations interested in participating in the expansion and continuation of this critical research effort can contact Amy at Amy_Crews_Cutts@freddiemac.com.

Institutional Partners:

- Homer Hoyt Institute
- Freddie Mac
- Mortgage Bankers Association
- National Association of Realtors

Sustaining Benefactors:

- Andrew Davidson and Company, Inc.

Persons and organizations wishing to assist should make contributions payable to the **Homer Hoyt Institute**, referencing the **Subprime Crisis Research Program**.

White Paper Conference

"Policy Analysis of Alternatives for Dealing with the Subprime Crisis"

Sponsored by the Subprime Crisis Research Council (SCRC)

Hudson Institute, Washington, D.C.

September 15, 2008

The culmination of SCRC activities during its first year will be presented in a penultimate draft of a White Paper, "Policy Analysis of Alternatives for Dealing with the Subprime Crisis," at an SCRC-sponsored conference to be held at the Hudson Institute, Washington, D.C. on September 15, 2008. Conference details are in process.

Dr. Robert Edelstein, director of the Fisher Center for Real Estate and Urban Economics, Haas School of Business, University of California - Berkeley, assisted by the senior research staff of the Fisher Center, Dr. Ashok Bardham and Dr. Cynthia Kroll, will produce the White Paper with the advice and counsel of a White Paper Task Force. Dr. Edelstein chairs the task force, consisting of Amy Crews Cutts, Andrew Davidson, Richard Green, Norm Miller, John Quigley, Patricia McCoy, Susan Wachter, John Weicher and Mark Zandi. The task force has the breadth of expertise required to analyze and integrate the many facets of the mortgage and credit crisis.

The White Paper will evaluate several proposals being advanced to deal with the complexities of the subprime crisis. Select proposals will be evaluated based on 1) fairness - who will be helped and who should be helped; 2) Net Impact or Bang for the Buck, i.e. the total macroeconomic benefits relative to the costs involved; 3) Distributional Impact, i.e. the disaggregated effects on different players in the housing market and on different geographic areas; 4) the Source of Financing and implications thereof; and 5) Future Mitigation of Moral Hazard and Return to Business as Usual, i.e. the sunset clause in each proposal and the potential for speedy recovery. Based on the findings of impact evaluation, an integrated, composite national policy will be recommended for addressing current problems in the housing and credit markets. The idea is that a generic strategy will be developed that is adaptable to the preferences of parties needing to forecast outcomes of alternative policies. **[Readers of this Newsletter are referred to this issue's Supplement entitled "Developing Policy for Dealing with the Subprime Crisis: A Matter of Justice," prepared by Dr. Maury Seldin, for insightful thoughts on the crisis.]**

The White Paper will be published and distributed by the SCRC. Copies can be requested by contacting Roberta Bernardini at the Homer Hoyt Institute, bernardini@hoyt.org, Hoyt Center, Suite 300 / 760 U.S. Highway One / North Palm Beach, Florida 33408-4424 / (561) 694-7621. Please reference "SCRC White Paper."

Attendance at the White Paper conference is limited and is by invitation only. Persons who wish to attend should contact Dr. John Weicher, Director, Center for Housing & Financial Mkts. / Hudson Institute / 1015 15th Street NW, Suite 600 / Washington, DC 20005-2605 / John@Hudson.org.

ASI News is published periodically by the Maury Seldin Advanced Studies Institute. If you have any questions and/or comments, or would like to submit an article to be considered for publication, please contact the Homer Hoyt Institute at (561) 694-7621 or email bernardini@hoyt.org.

The May 2008 Hoyt Fellows - Weimer School Session

The May 15-18 Hoyt Fellows and Weimer School sessions were attended by more than 50 Hoyt Fellows, Weimer School Fellows, Post Doctoral Honorees and invited guests. As customary, Weimer Fellows were encouraged to attend the Hoyt Fellow session and Hoyt Fellows to attend the Weimer School session.

May 2008 Hoyt Fellows

The May 15, 2008 Hoyt Fellows session was again most ably organized by Paige Mueller (GIC Real Estate, Inc.) and chaired by Dr. Jeff Fisher (Indiana University), the Managing Member of Hoyt Fellows, LLC. Presenting were Hoyt Fellows Dr. Mark Zandi (Chief Economist and Co-Founder, Economy.com), who spoke on the **"U.S. Economy and Housing Market Outlook"**; Richard Langhorne (First Vice President, CB Richard Ellis, Commercial Asset Recovery and Restructuring Services) **"Survivor - Who Gets Immunity at the Tribal Council - Florida and Other Sand States"**; Dr. David Lynn (Managing

Securities, Cornerstone Real Estate Advisers LLC) **"US REIT Markets-Change in Sentiment or Indication of Upcoming Private Market Pricing?"** and Hans Nordby (US Strategist, PPR) **"US Private Market Return Forecasts"**.



Featured Weimer School Speakers (L-R): Richard Langhorne (CB Richard Ellis) and Mark Zandi (Economy.com)

May 2008 Weimer School

The mortgage and credit crisis was the theme of the May 2008 Weimer School. Program chair Richard Green (George Washington University - now at the University of Southern California) with the assistance of Marsha Courchane (CRA International) organized a session of excellent presentations by Dr. Ann Schnare (AB Schnare and Associates, LLC) **"GSEs and the Liquidity Crisis in the Jumbo Market"**; Dr. Anthony Pennington-Cross (Marquette University) **"Mortgage Product Substitution and State Predatory Lending Laws"**; Dr. Karen Pence (Federal Reserve Board) **"The Subprime Mortgage Crisis: Underwriting, Mortgage Innovation, and Defaults"**; *(Cont. on page 5)*



L-R: Dr. Ann Schnare (AB Schnare and Associates LLC), Dr. Anthony Pennington-Cross (Marquette University) and Dr. Karen Pence (Federal Reserve Board)



Attendees at the May 16, 2008 Hoyt Fellows session

Director, Research and Investment Strategy, ING Clarion Real Estate) **"Land - the Next Big Opportunity or a Long Wait?"**; and Dr. Jun Han (Principal, Barclays Global Investors) **"Commercial Debt Markets - Opportunities and Risks."**

A panel consisting of moderator David Watkins (Senior Vice President, Heitman Capital Management) addressed **"2007 Corrections in US REITs and the UK Market - an Indication of 2008 Private Market Performance?"** Panel members Dr. Robert Zerbst (Chairman, CB Richard Ellis Investors) spoke on **"UK Market Correction and What We Can Learn from Derivatives"**; Scott Westphal (Managing Director -

The May 2008 Hoyt Fellows - Weimer School Session (Cont.)



Weimer School Speakers (L-R): Dennis Capozza (University of Michigan), Paul Willen (Federal Reserve Bank of Boston), Benjamin Keys (University of Michigan), Anthony Sanders (Arizona State University) and Amy Crews Cutts (Freddie Mac).

Dr. Jacob L. Vigdor (Duke University) "**What Should Government Do About the Subprime Mortgage Market? A Taxpayer's Guide**"; Dr. James D. Shilling (DePaul University) "**Moral Hazard and Adverse Selection for Subprime Lending and Securitization: Priced or not Priced?**"; Dr. Dennis Capozza (University of Michigan) "**Subprime in Shambles: New Indices for Underwriting Quality & Local Economic Conditions**"; Dr. Paul Willen (Federal Reserve Bank of Boston) "**Subprime Outcomes: Risky Mortgages, Homeownership Experiences, and Foreclosures**"; Deniz Igan (International Monetary Fund) "**Credit Booms and Lending Standards: Evidence from the Subprime Mortgage Market**"; Benjamin J. Keys (University of Michigan) "**Did Securitization Lead to Lax Screening? Evidence from Subprime Loans, 2001-2006**"; Dr. Anthony Sanders (Arizona State University) "**Housing Prices and Alternative Mortgage Concentrations**" and Dr. Amy Crews Cutts, (Freddie Mac) "**Interventions in Mortgage Default: Policies and Practices to Prevent Home Loss and Lower Costs**".

Post Doctoral Honorees

Each year the faculty of the Weimer School honors colleagues who have achieved recognition for their research early in their careers. These individuals are given the opportunity to present their research at the May Weimer School session and are invited to return to subsequent May sessions. Over time, several former Post Doctoral honorees have become Weimer School Fellows and Faculty. Dr. Richard Buttimer (University of North Carolina - Charlotte) and Dr. Charles Ka Yui Leung (City University of Hong Kong) were honored in 2008. Richard discussed "**A Generalized Real Options Model of Residential and Commercial Development,**" and Charles presented "**Do the Equilibrium Correlations of Asset Price Change with Monetary Policies?**"



2008 Post Doctoral Honorees Dr. Richard Buttimer and Dr. Charles Ka Yui Leung

Summaries of Hoyt Fellow, Weimer School Fellow and Post Doctoral presentations are given on pages 7 through 12 of this newsletter.

The 2008 Hoyt Fellows

Hoyt Fellows are the real estate industry counterpart to the Weimer School Fellows. Hoyt Fellows come from all aspects of the real estate industry and are characterized by their interest in research and policy. Each year, outstanding industry leaders are invited to join the Hoyt Fellows. The Hoyt Fellows inducted in 2008 were:

Michael J. Acton, CFA, is Managing Director and Director of Research at AEW with responsibility for directing the activities of AEW Research. One of the world's leading real estate investment advisors, AEW and its affiliates manage over \$35 billion of capital invested in approximately \$47 billion of property and securities in North America, Europe and Asia (as of December 31, 2007). On behalf of a wide range of institutional investors, AEW actively manages portfolios across the public and private markets and across the risk/return spectrum.

Alan Feldman, CRE, serves as Chief Executive Officer of Resource Real Estate ("RRE"), the wholly owned real estate subsidiary of Resource America, a publicly traded asset management firm with over \$17 billion of assets under management. Mr. Feldman oversees all of the firm's real estate activities, including its portfolio of approximately \$2.0 billion of assets and over 250 employees. RRE manages a diverse portfolio of equity and debt investments in apartments, hotels, shopping centers and other commercial assets.

Paul L. Jones, CPA, CRE, FRICS is President and founder of Pyramid Realty Group, a real estate consulting and investment banking firm serving a broad range of clients from Apollo Real Estate Advisors, LNR Property Co., Lehman Brothers, Deutsche Bank Securities, Goldman Sachs, JE Robert Companies, Secured Capital Corp, Carlton Group, Keefe, Bruyette and Woods, CBRE, Cargill, PM Realty, America's Capital Partners PSP Investments and Capital Partners.

James M. Sempere, CRE, FRICS is Managing Director, Global Head of Real Estate Investments and Research, Charles Schwab Investment Management (CSIM), San Francisco, where he has day-to-day management responsibility for all of Charles Schwab's Real Estate Investments and Research and sits on the Schwab Global Real Estate Fund Investment Committee and the Governance Committee for the S&P/GRA Commercial Real Estate Index (SPCREX).

Peter Slatin is the founder and editor of The Slatin Report, a Web-based commercial real estate newsletter launched in 2003. The slatinreport.com reaches 13,000 readers a week across the U.S. He is a financial columnist for Forbes magazine and the editor and publisher of the Forbes/Slatin Real Estate Report with Forbes.com, a monthly publication covering real estate securities. Mr. Slatin serves as Program Director for The Conference Board's Corporate Real Estate Conference, which he launched with them in 2005. In January 2008 Mr. Slatin was named Chairman of the Van Alen Institute, an urban design think tank based in Manhattan. He sits on the editorial advisory board of Real Estate Portfolio, the magazine of the National Association of Real Estate Investment Trusts, and on the Advisory Council of the New York Chapter of the American Institute of Architects.

May 2008 Presentations..In Summary

Includes Those of Hoyt Fellows, Weimer School Fellows,
Post-Doctoral Honorees and Guest Presenters

Subprime in Shambles: New Indices for Underwriting Quality and Local Economic Conditions

Dennis R. Capozza and Robert Van Order

Foreclosures can be decomposed into those due to underwriting and those due to national and local economic conditions. The recent explosion of defaults are due partly to both underwriting and economic conditions.

Foreclosures are most pronounced in subprime ARMs but both prime and subprime mortgages are showing similar effects. The effect on the reported MBA NDS data will persist for years because the reported data include the entire stock (all vintages) and are not reported by vintage. Default rates will return to trend eventually but not for a couple more years.

Interventions in Mortgage Default: Policies and Practices to Prevent Home Loss and Lower Costs

Amy Crews Cutts and William A. Merrill

The implosion of the subprime market in early 2007 caused by the rapid rise in mortgage defaults resulted in significant media and political attention focused on saving homeowners from foreclosure and the possible loss of their home. While the default problem in the prime segment of the market is much less severe, the issues around how to keep borrowers in their homes affect all market segments, not just subprime loans. In particular, what do we know about defaults and what causes them? Is there an ideal cost-benefit timeframe for the foreclosure process? What are the costs associated with foreclosure? Where will the next gains in default servicing come from to maximize the potential for borrowers to keep their homes?

We find that a large number of borrowers never speak with servicers when they are unable to make their mortgage payments, and that the longer they wait to do so, the less likely they are to recover from their problems and keep their home. Default counseling for delinquent borrowers is a cost-effective strategy for increasing borrower contact rates, and thus for increasing the share of borrowers who are underwritten for a successful home-retention workout with lower recidivism rates once a workout is in place.

We find that the foreclosure process varies widely across states and that the costs associated with foreclosure rise significantly with the length of the foreclosure timeline. Most importantly, we find that the likelihood a borrower will reinstate her loan out of foreclosure falls as the length of time in the foreclosure process increases – by our estimates, states with excessively long foreclosure timelines could increase the probability of successful reinstatement by 3 to 9 percentage points by shortening their statutory timelines to match the national median timeline. Timelines that give the borrowers too much time in the legal foreclosure process tip the balance from the threat of imminent home loss from foreclosure towards the benefit of “free” rent for the duration of the process, providing an incentive for borrowers to forego reinstatement of the loan even if they have the means to do so. By the same reasoning, some very short timeline states may find that lengthening their legal foreclosure timelines may improve cure rates out of foreclosure.

Commercial Debt Markets - Opportunities and Risks

Jun Han

This credit crunch is the worst in the history of commercial mortgage-backed securities (CMBS), but it has created attractive investment opportunities. Commercial real estate fundamentals are healthy, with a balanced market and very little new construction. The housing market correction, liquidity crunch, and slowing economy will create some pain. However, most fixed-rate, investment-grade conduit CMBS, the focus of this study, should do well in realistic credit stress scenarios with minimal risk of rating downgrades, defaults, credit losses, or yield degradation.

Fear and the liquidity crunch have driven CMBS and CMBX (a CMBS credit default index) spreads excessively wide: CMBX spreads imply very unreasonable default and lost expectations that are out of the realm of historical experience and real-world possibility. The Fed's rescue of Bear Stearns marked the bottom of the yearlong credit cycle. Liquidity has improved since then and will continue to improve. Most CMBX are undervalued based on the worst credit loss experience in history, presenting arbitrage opportunities even after the recent rally. CMBX are credit default swap indices on baskets of CMBS bonds. There are four vintages of CMBX indices outstanding. Each contains 25 CMBS deals and covers most of the capital structure, from BB (except CMBX.NA.1, which goes down to only BBB-) to super-senior AAAs.

Credit Booms and Lending Standards: Evidence from the Subprime Mortgage Market

*Deniz Igan, with Luc Laeven
and Giovanni Dell'Ariccia*

The current subprime mortgage crisis is linked to a decline in lending standards associated with the rapid expansion of this market. Lending standards are shown to have declined more in areas that experienced large credit booms and house price increases. The underlying market structure also mattered, with entry of new, large lenders triggering declines in lending standards by incumbent banks. Finally, lending standards declined more in areas with higher mortgage securitization rates. The results are consistent with theoretical predictions from recent financial accelerator models based on asymmetric information, and shed light on the relationship between credit booms and financial instability.

Do the Equilibrium Correlations of Asset Price Change with Monetary Policies?

*Charles Ka Yui Leung
with Wing Leong Teo*

It seems that every financial crisis reminds us of and revives the following questions: Should the central bank react to the asset price fluctuations? Should the optimal portfolio depend on the monetary policy regimes? This paper takes an initial step towards addressing these questions by examining whether (and how) the correlation among asset prices, as well as the serial correlations of different asset prices, may vary under different monetary policy regimes. More specifically, this paper builds a dynamic stochastic general equilibrium (DSGE) model with nominal rigidities, which mimic certain stylized facts of the US aggregate economy. The preliminary findings are as follows. In general, while a stock price inflation-targeting policy may stabilize the relative volatility of stock prices, it may de-stabilize house prices, and vice versa, which suggests an important tradeoff in monetary policy considerations. Second, the serial and cross-asset correlations and relative persistence of asset prices are positive. Their values can also be significantly different under different monetary policy regimes. (*Cont. on page 9*)

Do the Equilibrium Correlations of Asset Price Change with Monetary Policies?

Charles Ka Yui Leung with Wing Leong Teo (Cont.)

This finding is consistent with the empirical findings of Quan and Titman (1999) that correlations among asset prices vary across countries. It also suggests that optimal portfolio allocations may need to be country-specific and policy-dependent, although more careful research is needed on this issue. This paper also produces impulse responses of asset prices and the nominal interest rate. The similarities of some of these impulse responses suggest cautions in the empirical identification of which monetary policy would be the best description of the historical data.

Land - the Next Big Opportunity or a Long Wait?

David J. Lynn

Land investment is an inherently risky real estate strategy because of the time involved in moving a project through the entitlement and development process and the lack of cash flow during that period. However, land investment opportunities exist in a variety of markets: distressed, high-growth and infill.

The decline in prices, the time to "reach the bottom", and the time to return to the previous peak will vary considerably by market. The recovery could begin in early 2009, but the return to peak values will take years, not months. Locations matters - infill locations offer the best opportunity to mitigate risks, given relatively consistent demand and high values.

Eight Propositions About Subprime Mortgages

Karen M. Pence

Although subprime mortgages are now a subject of conversation throughout the United States, some surprisingly basic facts about subprime mortgages remain widely unknown. To start, there is no standard definition of a subprime mortgage; instead, there are datasets that capture information on mortgages that are more likely to default. These datasets provide somewhat different pictures of how rapidly subprime mortgage originations increased over the past decade. However, they provide similar pictures of what areas of the United States saw more subprime originations in 2005: areas with high price appreciation, considerable new construction, and more residents who have low credit scores, are unemployed, or are minorities.

Subprime mortgages tend to be more complicated contracts than prime mortgages, and are also more likely to be ARMs. A large share of borrowers with ARMs appear to underestimate or not know the amount by which their interest rates can change. ARM borrowers who don't know these contract terms are more likely to be age 65 or older; have less education; be minorities; and be afraid of being turned down for loans.

However, although ARM borrowers appear to have difficulty understanding their interest rates, the complicated structure of subprime mortgage products does not appear to explain why mortgage delinquencies have risen so sharply over the past year. For example, although the payments on subprime ARMs may rise after an initial two or three year fixed-rate period, most of the increase in delinquencies has occurred during the fixed-rate period, not after the interest rate change. Instead, a deterioration in underwriting-and in particular, an increase in loan to value ratios-and declining house prices appear to be significant culprits in the rise in delinquencies.

Housing Prices and Alternative Mortgage Considerations

Anthony B. Sanders

Most studies focus on subprime and alternative mortgage products at a macro level. This study focuses on the micro level using Maricopa County (Phoenix), Arizona. Maricopa County, which includes Phoenix, experienced dramatic house price growth in 2004 and 2005, a slowdown in 2006 and dramatic declines in 2007. Are increases in default by zip code based on the mortgage product and house price declines?

The highest volume of loans from 2004-2006 were located in the new-build areas (Southeast, West and North). The subprime loans appear in high volume in the new-build areas of the southeast (Queen Creek) and west. But subprime loans as a percentage of all loans were highest in the lower-income neighborhoods of Phoenix (downtown, older homes along the interstates going west and north from the downtown). Interestingly, IO ARMS (interest only adjustable rate mortgages) are located in the highest price areas of Maricopa County (Scottsdale, Paradise Valley and Ahwatukee), but far less than in the high subprime concentration zip codes.

The highest foreclosure zip codes in Maricopa County correspond to the high subprime concentration zip codes around downtown Phoenix and going west along the I-10. In addition, the new-build zip codes in west Maricopa County (Buckeye, Goodyear) and north (Anthem), Westside communities, Peoria and Glendale, also suffered large foreclosures. So foreclosures correspond to both low-income area subprime concentration and new-build zip codes on the urban/rural periphery. Each of these zip codes have suffered in terms of housing price declines. Conversely, the high IO ARM zip codes (Scottsdale, Paradise Valley, Ahwatukee) have low foreclosure counts.

The GSEs, Jumbo Mortgages and the Liquidity Crisis: Do Regional Adjustments to the Conforming Limit (Still) Make Sense?

Ann Schnare

Government Sponsored Enterprises (GSEs) are traditionally subject to national loan limits with exceptions: 50% higher in Alaska, Hawaii, Virgin Islands and Guam. The 2008 Economic Stimulus Act increased Corporate Limited Liability (CLL) to 125% of median house price in the highest priced county in a Metropolitan Statistical Area (MSA), up to 175% (\$729,750) of the current ceiling. The high cost adjustments also apply to FHA. Seventy-one high cost metropolitan or "micropolitan" areas are affected. The provision is scheduled to expire at the end of the year, but proposed legislation would make the adjustments permanent (but capped at 150%).

Analysis using 2003 HMDA data and a 150% cap found that the total number of loans eligible for GSE purchase would increase by about 2 to 3 percent and the increase in seven high cost markets would average about 15 percent, ranging from 2 percent in Washington to 48 percent in San Francisco.

The impact of the current increase is likely to be higher due to house price appreciation since 2003, a higher cap (175%), and a broader definition of "high cost" markets. Despite these differences, the major impact is likely to be limited to a relatively small number of MSAs. Increases in the conforming limit have not kept pace with house price appreciation in high cost markets. Homebuyers in high cost markets are less likely to use conventional conforming mortgages and FHA loans, and more likely to use jumbo and subprime loans. High cost areas have lower homeownership rates and a disproportionate share of minority households. The net result is geographic inequities in the distribution of GSE benefits.

Moral Hazard and Adverse Selection for Subprime Lending and Securitization - Priced or not Priced?

James D. Shilling, with Jonathan Dombrow and Gail Lee

The typical tranching structure allows lenders to expand the market for subprime mortgages and reduce costs. On the minus (cost) side is the possibility of moral hazard and adverse selection. The latter comes from the fact that the originator no longer owns the first-loss piece. With moral hazard comes either pooled or tiered pricing.

The hypothesis is that subprime lenders who originate low quality loans should be charged different prices than subprime lenders who originate higher quality loans. The Market lends itself to tiering, but then again, does anyone have good information about subprime mortgages?

Loan denial rates and loan performance histories indicate whether loans sold are of high or low quality.

Typical tranching of subprime mortgages raises the theoretical risk of moral hazard and adverse selection. Tests of tiering finds evidence of a tiering equilibrium in which loan performance histories influence initial yields on subprime ABS loans. However, the model cannot tell us whether prices are too high or too low.

What Should Government Do About the Subprime Mortgage Market? A Taxpayer's Guide

Jacob Vigdor

The current subprime mortgage situation reflects the predictable result of simple economic forces: greater access to credit means more home buyers bidding up home prices, increasing the demand for mortgage products with "affordability" features, attracting more brokers and lenders to the market, who competed for more borrowers, who bid on more homes, causing prices to rise...a self-reinforcing cycle but not one that could last forever. When the boom turned to bust, as it has before, lenders and borrowers alike were left to face the consequences of their choices.

We can learn from the current problems, and take reasonable steps to help lenders and borrowers make well informed decisions in the future. Government cannot stop the housing market from expanding and contracting, but it can make future contractions less painful.

- It can require that borrowers receive complete, accurate and intelligible information about mortgage products.
- It can help lenders and brokers to higher, more uniform standards during loan origination increasing the likelihood that borrowers will be able to repay their debts
- It can support community-based groups that provide counseling to homeowners, helping them understand how to live within a budget, how to manage debt, how to deal with unanticipated financial setbacks, and how to negotiate with lenders.

Mortgage risks created by ignorance or avarice can and should be reduced. But risk cannot be eliminated from the process; it is an inherent part of the mortgage market. (*Cont. on page 12*)

What Should Government Do About the Subprime Mortgage Market?

A Taxpayer's Guide - *Jacob Vigdor (Cont.)*

Bailouts and moratoria after the mutually agreed-upon risk sharing between lender and borrower, undermine the expectation that contracts will be enforced as written, and alter borrower and lender behavior in ways that make those measures unlikely to achieve their intended goals while their costs are borne primarily by taxpayers and consumers who played no role in creating the problem. They are not the solution.

Subprime Outcomes: Risky Mortgages, Homeownership Experiences and Foreclosures

*Paul Willen with Kristopher Gerardi
and Adam H. Shapiro*

The cumulative probability of foreclosure in Massachusetts is 18% for borrowers who used a subprime mortgage to purchase their home, and 3% for borrowers who used a prime mortgage. Foreclosure is highly sensitive to house price appreciation experience. The main determinants of the recent foreclosure crisis in Massachusetts are: negative house price appreciation and increased activity in the subprime purchase mortgage market that created a large class of vulnerable borrowers. The story goes something like this: borrowers were lured in by a "below-market teaser" and can afford the payments, then reset hits and payment "explodes". Negative equity is necessary but not sufficient for foreclosures. In other words, if equity is positive almost no one defaults (because they can sell at a profit); if equity is negative, then default may make sense, but it depends on other things. Why should you hold on to a house when you have negative equity? You will eventually make money, but it depends on whether you can wait that long.

Colleagues in the News...

Dr. Danny Ben-Shahar, Dr. Charles Ka Yui Leung and Dr. Seow Eng Ong are editors of Mortgage Markets Worldwide (Blackwell Publishing, May 2008). The book analyzes mortgage markets in several countries, presenting an institutional, theoretical evaluation of different housing finance systems. Other Weimer School Fellows contributed to the book.

Dr. Robin Dubin has been promoted to full professor and will be Associate Dean for Graduate and Professional Programs at the Weatherhead School of Management, Case Western Reserve University.

Dr. Donald Epley is now the Director of the Center for Real Estate Studies at the University of South Alabama. The Center sponsored a Coastal Commercial Property Summit in February attended by 350 people. A second event on the Coastal Economy will be presented in September where a panel, including Epley, will present their analysis of the direction and strength of the Coastal economy. The featured speaker will be Ms. Sheila Bair, Chair, Federal Deposit Insurance Corporation, Washington.

Dr. James Follain has written a series of articles over the past year (with wife, Barbara) for a new web site: www.cyberhomes.com. The latest two are "A Mortgage Modeler Offers Subprime Crisis Hindsight" and "Tracing the Trail of Relief." Several more are planned this summer. The links to the two articles are as follows: <http://www.cyberhomes.com/readingroom.aspx?article=subprimelendingpatte> and <http://www.cyberhomes.com/readingroom.aspx?article=foreclosurerelief>.

Dr. Donald Haurin has been named as Chair of the Department of Economics at the Ohio State University.

Dr. Michael LaCour-Little has been appointed to the California State University at Fullerton Housing Authority by University President Milton Gordon. The CSUF Housing Authority develops affordable housing for university faculty and staff. (*Cont. on page 13*)

Colleagues in the News...(Cont.)

Dr. Steven LaPosa is now the Loveland Commercial Endowed Chair in Real Estate, College of Business, Colorado State University. Steve will maintain a continued working relationship with PricewaterhouseCoopers' Global Real Estate Research group.

Dr. Glenn R. Mueller co-authored the research study "Colorado's Commercial Real Estate Industry Statewide Economic Impact Report" in January 2008 for NAIOP; developed a Real Estate Market Cycle Course for the CCIM Institute, and is researching the "Economic Determinants of Development" for NAIOP national.

Dr. Seow Eng Ong was promoted to Full Professor in the Department of Real Estate, School of Design & Environment of the National University of Singapore in 2007. In 2008, he was elected for a three year term to the AREUEA Board of Directors.

Dr. John M. Quigley was awarded an honorary degree by the Royal Institute of Technology in Sweden. He was cited as "the world's eminent researcher in the fields of housing and urban economics as well as in areas related to public economics and infrastructure investment." He gave the keynote address at the Shanghai Forum in May and also at the annual meeting of the Asian Real Estate Society (AsRES) in July.

Jeanette I. Rice is serving as the 2008 President of the Dallas/Forth Worth Association for Business Economics, the local chapter of the National Association for Business Economics.

Dr. Stephen L. Ross was promoted to Full Professor in the Economics Department of the University of Connecticut in Fall, 2007.

Dr. Maury Seldin was recognized in April by the American Real Estate Society, which gave him the Pioneer Award. The award was given "in recognition of his life-long pursuit of cutting edge scholarly inquiries improving land use analysis and decisions and real estate education paradigms."

Larry Souza announced that in August of 2007, Standard & Poor's, Global Real Analytics (GRA)/Charles Schwab Investment Management jointly launched a monthly series of constant-quality transaction-based commercial real estate price indices (SPCREX) to help drive a new and exciting area of commercial real estate capital markets and modern portfolio applications. These indices were designed specifically for use in commercial real estate, economic and capital market research; portfolio benchmarking and attribution analysis; and the basis for exchange (CME) and over-the-counter (OTC) property derivatives trading. Index data and related methodology papers are available at www.spcrex.standardandpoors.com. If members would like to receive monthly news letters and analytics based on these indices, they can send an e-mail to Larry Souza, Managing Director - Index Services (Larry.souza@schwab.com) or call (415) 636-3030. Global Real Analytics (GRA)/Charles Schwab Investment Management encourages the academic community to use these indices in their research and are available for advice and support.

Dr. Kerry Vandell is director of the Center for Real Estate and head of the real estate business program at the Merage School of Business at the University of California - Irvine, which opened its newly constructed center in March. Information about the activities of the Center and the UCI real estate program can be obtained from the Center's website: <http://merage.uci.edu/ResearchAndCenters/CRE/Default.aspx>.

Dr. Christine Whitehead technically retired from the London School of Economics in October, 2007. However, the result has been more rather than less work - for LSE, for the Cambridge Centre for Housing and Planning Research, for government and in terms of policy based research. She participates in the European Network of Housing Research and is hoping to complete joint research with colleagues in Scandinavia, France and Australia on housing finance, the role of social housing and the relationship between land use planning and housing over the coming year.

Colleagues in the News...

(Cont.)

Dr. John Williams was appointed to two AACSB, International Accreditation Committees: Thought Leadership and Business/Economics Research Impact on Practice. He was also named by the AACSB Nominating Committee as a nominee to serve on its Board of Directors.. In addition, he was elected as President of the HBCU Business Deans' Roundtable and is serving as Program Chair for the ARES 2009 Annual Meeting in Monterey, California.

Dr. Abdullah Yavas has been appointed to the Monetary Policy Committee of the Central Bank of the Republic of Turkey. The Monetary Policy Committee is the Turkish equivalent of the U.S. Federal Reserve's Federal Open Market Committee. In addition to Yavas, the committee includes the governor and vice governors of the Turkish Central Bank and a member of the bank's board. Yavas will serve on the seven-member committee for five years, while continuing as a faculty member at Penn State.

MSASI and Weimer School Events and Awards

2009 AREUEA Breakfast

MSASI will sponsor its annual breakfast for Weimer and Hoyt fellows, Weimer Fellow Candidates, Post Doctoral Honorees, AREUEA Dissertation winners and MSASI winners recognized by AREUEA and ARES during the 2009 AREUEA meetings, January 3-5, 2009 in San Francisco, CA. Invitations containing particulars will be sent this Fall and a prompt reply will be appreciated.

2008 ARES Breakfast

MSASI hosted its annual breakfast at the April 2008 ARES meetings at the South Seas Island Resort, Captiva Island, Florida. More than 40 persons attended.

ARES Awards

The MSASI-sponsored prize for the "Best" Paper on Innovative Thinking, given at the annual ARES meetings, better known as the "Thinking Out of the Box" paper is currently being determined and will be announced at a later date.

The MSASI annual award for the "Best" 2008 research paper published in ARES Journal of Real Estate Research will be announced by ARES early in 2009.

AsRES Awards

This year's winner of the Maury Seldin Advanced Studies Institute-sponsored "Best" Paper award is Dr. Andra Ghent, Department of Economics, University of California, San Diego. The title of her paper is "Sticky Housing and the Real Effects of Monetary Policy."

Mark Your Calendars for the January 15-19, 2009 Weimer School Session

The January 15-19, 2009 session of the Weimer School will be held at our North Palm Beach, Florida campus. Registration materials will be coming this Fall. The session is during the Florida tourist season. ASI has a number of rooms reserved at the Hilton Singer Island Resort and an early guarantee is required by the hotel. When your invitation arrives via email or snail mail, **please return your registration and room reservations as soon as possible to ensure accommodations.** *(Cont. on Page 15)*

**Mark Your Calendars for the
January 15-19, 2009 Weimer School Session (Cont.)**

Candidates who are presenting in 2009 to complete the requirements to become a Weimer School Fellow are: **Dr. Alex Anas** (State Univ. of NY Buffalo), **Dr. Danny Ben-Shahar** (Technion-Israel Institute of Technology), **Dr. N. Edward Coulson** (Pennsylvania State University), **Dr. Ingrid Gould Ellen** (New York University), **Dr. John Harding** (University of Connecticut), **Dr. Katherine O'Regan** (New York University), **Dr. Francois Ortalo-Magné** (University of Wisconsin-Madison), **Dr. Todd Sinai** (University of Pennsylvania), **Dr. Dogan Tirtiroglu** (University of Adelaide – Australia), **Dr. Walter Torous** (UCLA Anderson School of Management) and **Dr. Geoffrey Turnbull** (Georgia State University).

The incoming Class of 2009-2010 are: **Dr. Amy Crews Cutts** (Freddie Mac), **Dr. Raphael Bostic** (University of Southern California), **Dr. Daniel McMillen** (University of Illinois at Chicago), **Dr. Sandra Newman** (Johns Hopkins University) and **Dr. Massimo (Max) Biasin** (University of Macerata - Italy).

The 2009 Honorary Fellow is **Dr. Peter Mieszkowski** (Rice University).

2008 Annual Development Fund Drive

MSASI, HHI and Hoyt Fellows LLC will be conducting their annual development fund drive this winter. Please look for your letter in November. We ask that you continue to remember MSASI, HHI and the Hoyt Fellows LLC when planning your annual giving.

Recent donors:

Hoyt Fellows LLC generously donated to MSASI, at their May meeting, in support of the Weimer School.

Dr. Dan Kohlhepp (Hoyt Fellow, 2007) (Crescent Resources, LLC) generously donated to MSASI.

Andy Davidson (Hoyt Fellow, 2005), (Andrew Davidson & Co., Inc.) generously donated to HHI in support of the Subprime Crisis Research Program.

Our sincere appreciation for their support of the missions and programs of the Hoyt Group organizations.

Property Donations

HHI actively solicits gifts of real property interests

The administration of HHI would be pleased to discuss the financial and non-financial benefits of a donation with any interested individuals or organization. Transfer may be part gift and part sale. Such gifts support real estate education and research through the Homer Hoyt Institute and the Maury Seldin Advanced Studies Institute.

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CALENDAR OF EVENTS

AUGUST 2008

**REALTOR.org
2008 Leadership Summit**
August 21-22
Chicago, IL

OCTOBER 2008

**IREM Fall Business and Governance
Meetings**
October 14-16
Hilton Chicago
Chicago, IL

**2008 Urban Land Institute (ULI) Fall
Meeting and Urban Land Expo**
(Open to all)
October 27-30, 2008
Miami Beach Convention Center
Miami Beach, Florida

OCTOBER 2008 (CONT.)

**The Counselors of Real Estate (CRE)
Annual Convention**
October 31-November 3
The Fairmont Copley Plaza
Boston, MA

NOVEMBER 2008

**2008 REALTORS® Conference &
Expo**
November 7-10
Orlando, FL

NAREIT Annual Convention
November 19-21
(Registration opens August 2008)
Manchester Grand Hyatt
San Diego, CA

JANUARY 2009

**AREUEA
2009 Annual Conference**
January 3-5 / San Francisco, CA

**Weimer School and Hoyt Fellows
LLC**
January 15-19
Hoyt Center / North Palm Beach, FL

APRIL 2009

**ARES
25th Annual Meeting**
April 1-4
Monterey Marriott / Monterey, CA

MAY 2009

**Weimer School and Hoyt Fellows
LLC**
May 14-17
Hoyt Center / North Palm Beach, FL

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