

Researchers collaborate on subprime lending investigation

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(Phys.org) —A recent article, appearing in the *Journal of Urban Economics*, authored by Penn State faculty member Brent Ambrose, Smeal Professor of Risk Management in the Smeal College of Business, and former doctoral student Moussa Diop examines the effects of subprime mortgage lending on the multifamily renting market. They found that subprime lending had a significant effect on rental defaults, which affected rental rates and property valuations.

Diop, now an assistant professor of real estate and urban land economics at the Wisconsin School of Business, began his research with Ambrose in the second year of his doctoral studies.

"Brent always has a lot of great research ideas," said Diop. "We all know that real estate markets are integrated, but when people were talking about the subprime mortgage crisis, they were only looking at housing, not at what was happening to the rental market. Nobody had told that story yet."

In examining the role that subprime mortgage lending played in the global financial crisis in 2007 and 2008, Ambrose and Diop noted a gap in understanding the impact of mortgage credit expansion on the rental market.

"As we began our research, we did expect a negative effect on the rental market, which we found," said Diop.

Because subprime lending allowed a larger segment of the population to enter the housing market, those remaining in the rental market were likely riskier and therefore more prone to default on their leases, all else the same.

"[A] 1 percent increase in [subprime mortgage](#) origination activity corresponds to an approximately 1.9 percent increase in the rental market lease default rate," write the authors.

And that increased risk profile led to higher rental rates among lower income populations.

"[T]o the extent that a larger portion of the lowest income segment of the population remains in the rental market, the expansion in [mortgage](#) credit may have had a disproportionately negative impact on this segment of the population least able to bear the consequences of the increased rental rates that resulted from the shift in the rental population risk profile," the authors write.

They continue, "Overall, our analysis demonstrates an interconnected [real estate](#) market such that an exogenous shock in one part of the market inevitably produces ripple effects on the other sectors."

Diop says that the experience of working on and publishing a research project with Ambrose enhanced his Ph.D. Program experience by giving him the opportunity to increase his abilities as a research scholar.

"Coursework doesn't really prepare you to do the level of research necessary for success in academia; you really have to get involved in research as early as possible," said Diop. "The willingness of Brent and the other faculty to work with Ph.D. students on research projects is a real plus. A lot of programs don't really offer that."

More information: Brent W. Ambrose, Moussa Diop, "Spillover effects of subprime mortgage originations: The effects of single-family mortgage credit expansion on the multifamily rental market," *Journal of Urban Economics*, Volume 81, May 2014, Pages 114-135, ISSN 0094-1190, [dx.doi.org/10.1016/j.jue.2014.03.005](https://doi.org/10.1016/j.jue.2014.03.005).

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