

Subprime Loans = Primetime for Vampire Lenders

By [Jim Hightower](#), [Hightower Lowdown](#). Posted [August 22, 2007](#).

How "reputable" financial firms are using an arsenal of tricks to extract high payments from homeowners, drain their equity and steal their homes.

**Tools**

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One of the most dramatic stories from the New Testament is of the time that Jesus encountered money changers in the temple. Enraged by their usury and sacrilege, he went on a tear -- overturning their tables, physically driving them out and chastising them for converting the temple into a "den of robbers." The Bible doesn't say where these bloodsucking lenders went, but now we know: They have re-emerged in recent years to set up their tables right here in America, working a dark alley of homeowner financing called the "subprime mortgage market." The what? Don't be deterred by the finance industry's jargon (which is intended to numb your brain and keep regular folks from even trying to figure out what's going on). At its core, this is a classically simple story of banker greed and outright sleaze. And the astonishing part is that nearly all of the rank injustice perpetrated by today's money changers is considered legal and is practiced by supposedly reputable financial firms.

That's when avaricious mortgage hucksters and high-finance manipulators looked upon this broad pool of needy, vulnerable castoffs and suddenly shouted, "Eureka, GOLD!" With interest rates remarkably low, housing prices seemingly on a nonstop rise, and (this is the Big One) practically no regulation of this low-income market, the money changers promptly began to devise clever, Enronian schemes to entice such "subprime" borrowers into high-interest, high-fee loans. Never mind that these families really could not afford (and mostly did not understand) the level of debt being piled on their backs. That was a matter for manana. Today was for raking in profits from the poor.

The subprime schemes are run through an intricate, intertwined system of loan brokers, mortgage lenders, Wall Street trusts, hedge funds, offshore tax havens and other predators. To entrap borrowers, the industry created an arsenal of arcane financial devices and maneuvers known by such exotic names as "exploding ARMs," YSPs, teaser rates, low-doc mortgages, loan flipping and equity stripping. Ultimately, these schemes are scams, extracting high payments from the families, sucking out any equity they might build up and stealing their homes.

This is one of those economic stories, like the savings-and-loan scam of the 1980s, that are usually buried back in the business section of newspapers. But, just as with the S&L collapse, this debacle is growing too big to contain, and all of us need to be paying attention. The built-in traps of the subprime mortgage market have already taken the homes of more than a million people in just the past year, and the dangers are quickly rising for millions more. This collapse in homeownership for the working poor has begun seeping into the rest of the economy, causing thousands of job losses, shaking the soundness and reputations of some major Wall Street firms, and slowly -- ever so sloooowly -- forcing lackadaisical bank regulators and clueless politicians out of their laissez-faire stupor.

### **How it works**

You might have seen some of the come-ons: "Bad Credit? No Problem!" "Zero Percent Down Payment!" "Creative Financing!" "No Documentation Needed!" "Quick and Easy Money!"

The key to building the subprime market is hustle and flimflam -- trying to rush anxious, uninformed people into signing on the

dotted line for what they're assured is the deal of a lifetime. Of course, the mortgage industry casts its work in a noble light, asserting that its primary purpose is to help extend the joys of homeownership to the masses. But an examination of key players reveals little altruism.

**BROKERS.** These are independent, local operators who troll for borrowers in your town and mine, using flyers, doorbells, phone calls, personal contacts, websites, late-night TV ads, data banks and every means imaginable to get low-wage renters to sit still for a home-loan sales pitch or to find vulnerable homeowners who can be talked into taking out a refinancing loan. Brokers don't actually make the loans, service them or have any stake in whether the deals work out. Rather, they are simply "finders" who are paid an upfront fee by the mortgage lenders for every borrower they deliver. And 71 percent of all subprime mortgages come through them.

The pretense is that the broker is the borrower's trusted advisor in the shark-infested waters of banking. Au contraire, Bubba. In most states, agents have no legal responsibility to represent a buyer's best interest. And, in fact, they don't, for the system gives brokers lucrative incentives to deceive borrowers.

Through a common practice called "steering," unsuspecting families are guided into the most expensive, riskiest subprime loans. For doing this dirty job, brokers are paid cash bonuses called "yield spread premiums" (YSPs) -- though you would call them by their more common name: kickbacks. The Center for Responsible Lending reports that these YSP payoffs, averaging \$1,850 per loan, are added to about 90 percent of all subprime loans. That's right, struggling families are silently assessed an extra fee for being secretly steered into a loan with higher interest rates and worse terms than they're entitled to get. They're literally being robbed by their bankers.

**LENDERS.** These are the brand-name players you might recognize. They include nonbank lenders -- for example, New Century Financial, Ameriquest, Option One, Countrywide and Ownit Mortgage Solutions -- that sprang up to tap into the new subprime

gold rush, and several of them are now bankrupt or under investigation. Many big banking firms, including Wells Fargo, Lehman Brothers and Citigroup, also joined the free-for-all by setting up their own subprime subsidiaries,

Brokers are on the front lines, but the lenders are the ones who invented the scams that are bleeding borrowers. Only a decade ago, subprime loans were a mere fraction of the home-loan market. Today, these financial instruments are an \$800 billion business -- about 20 percent of all housing loans.

How did the subprime market mushroom? The lenders -- again, they are not subject to regulation -- drastically and deceptively lowered normal banking standards to draw in low-income borrowers. As one broker says, "The culture around all these subprime lenders has been, 'Hey, bring it to us. We'll make it happen.'" If a borrower can pay little or nothing down, recently had a bankruptcy, and doesn't have the income to keep up payments, the bankers say, "That's OK. Bring us that loan."

Rather than do due diligence, lenders cavalierly offer "low-doc" and "stated income" loans -- i.e., they make little or no effort to document an applicant's ability to take on this burden, instead accepting almost anyone's word about having the income to meet monthly payments. "You could be dead and get a loan," says one broker.

The loans themselves are doozies, filled with numerous and nasty provisions that set unwitting borrowers up for failure. These are tucked into 20-page loan agreements written in legal gibberish. A friendly, reassuring, always smiling loan agent flips through the pages saying, "It's simple, just sign here ... and here ... and here." Among the nasties are:

- **TEASERS.** Subprime interest rates are loudly advertised to be only 7 percent or so, with only small-type notice that these are "adjustable rate mortgages" (ARMs). This means that the interest rate will explode to 11 percent or more after a couple of years, causing the families' monthly payments to jump by half or more. Over 90 percent of subprime loans contain ARMs.
- **BLOATED APPRAISALS.** Subprime lenders are notorious for pressuring appraisers to inflate the value of a house, thus causing the borrower to take out a bigger loan than the house is worth.
- **HIDE-THE-ESCROW.** In conventional loans, the borrower's property taxes and mortgage insurance premiums are figured directly into the monthly loan payments, with these monies set aside in an escrow account. For subprime loans, however, lenders often don't include these costly items in the mortgage, thus making the loans appear more affordable than they really are. This leads to borrower shock (and sometimes default) when the tax and insurance bills arrive separately in the mailbox. At this point, ever-helpful lenders offer to refinance the loan, thus collecting additional fees.
- **EXCESSIVE FEES.** On conventional mortgages, various lender fees typically total less than 1 percent of the loan amount. By contrast, subprime borrowers commonly are hit with fees (hidden in mortgage payments) totaling more than 5 percent.
- **PREPAYMENT PENALTIES.** Obviously, it's in a borrower's interest to get out of an abusive subprime loan as soon as possible and to refinance on better terms. But --Gotcha! -- more than 70 percent of these loans carry a penalty fee of several thousand dollars for paying off the loan early. In the prime market, only about 2 percent of loans contain such punishment.
- **WALL STREET.** None of the above would be happening (and certainly not on such a massive scale) if the fast-and-easy money crowd on Wall Street hadn't seen a chance to make a killing on lowly subprimers. Lured by the flow of sky-high interest rates being charged to these borrowers (and abetted by the lack of government regulation in this market), Bear Stearns, Lehman Brothers, Merrill Lynch, Goldman Sachs and other giants lumbered into the action.

They set up special investment units within their banks to buy these risky mortgages from the lenders. Then the Wall Street behemoths consolidated this bulk debt, leveraged it into complex IOUs called "mortgage-backed securities," and sold these packages to wealthy speculators around the world. This Rube Goldberg financial mechanism has shoved hundreds of billions of dollars of capital into the subprime market, fueling lenders' enthusiasm for making even more of these shaky loans.

Mr. and Ms. Subprime live on the economic edge, with little margin for financial downturns. In the last couple of years, three bad storms hit them. First, falling wages combined with growing inflation (fueled by rising prices for gasoline, utilities, healthcare, etc.) to squeeze their meager household finances to the breaking point. Second, their adjustable-rate mortgages began exploding; someone who was paying \$1,000 a month at the start of a \$150,000 loan had to pay \$1,400 a month two years later.

Third, housing prices (which the whole system claimed would only rise and rise and rise) began tumbling, making it impossible for these borrowers to refinance or sell their homes to avoid financial foreclosure. When home sales were booming, George W declared this proved that his push for economic deregulation was creating a glorious new "ownership society." He was so enthused that he even designated June as National Home Ownership Month. But his laissez-faire "success" turns out to be a house of cards. As one market analyst says, "The gain in home ownership over the last four or five years is almost entirely due to looser lending standards [for subprime mortgages]."

Those cards are now crashing down. In the first half of this year, home foreclosures are up by 41 percent. Today, a record number of subprime borrowers have fallen behind in their monthly payments and face eviction (once you fall 90 days behind, lenders typically proceed with foreclosure). More than \$2.28 trillion worth of ARMs are scheduled to explode to their higher interest rates between now and 2009. Two million families are expected to have the wrenching experience of losing their homes, as well as losing all the money they invested in them.

All of this is working its way up the economic chain. More than 80 lenders have gone out of business in the past six months, thousands of jobs are being cut, and hundreds of thousands of houses are being dumped on an already-saturated market (causing a further decline in prices, which makes other subprime homeowners even more vulnerable to foreclosure, which dumps more houses onto the market ... and the downward spiral continues).

Wall Street big shots are being stung as well. Bear Stearns, for example, has had to scramble to keep its two subprime hedge funds from imploding, bailing out one of them with a panic infusion of \$1.6 billion. Analysts estimate that these funds are holding more than \$200 billion worth of subprime loans that are in danger of default.

## **Regulatory shame**

This abuse of vulnerable families and the resulting economic mess would not have happened without the hands-off regulatory ideology that has infected our government. There are no less than five financial agencies at the federal level that could have protected people, yet the subprime surge was allowed to proceed on the fantasy that the financial players would police themselves. The Federal Reserve Board, for example, has direct authority under the Home Ownership and Equity Protection Act to "prohibit acts or practices in connection with mortgage loans that the board finds to be unfair, deceptive or ... associated with abusive lending practices, or that are otherwise not in the interest of the borrower." The Fed simply ignored this law.

Finally, with the entire subprime system crashing around them, the regulators issued "guidelines" on June 29 requiring banks to stop some of the worst abuses, including prepayment penalties. But the new rules still allow many of the predatory practices and -- worst of all -- do not apply to the nonbank lenders that make a large share of subprime loans. In addition, the guidelines do not directly address the role of Wall Street in pushing such loans.

The subprime industry disingenuously asserts that any attempt to regulate it only hurts the poor people who receive these mortgages, for they have nowhere else to turn for homeowner financing. What self-serving hogwash! There could be subprime loans -- from public, if not private, sources -- structured and administered without deceit. Rather than target lower-income families as suckers to be had, packaging their dreams into investment playthings for speculators and tax dodgers, let's view these folks as assets to the larger community and realize that homes for them are investments in the common good. And while we're at it, let's recognize that the need for "subprime" mortgages is driven by our low-wage/no-benefit economy and by our country's growing scarcity of affordable housing. It's not merely a low-income mortgage system that must be fixed -- our leaders' pursuit of a low-income America must be stopped.

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What a system! Lenders mislead borrowers, collect fat fees from them, then shift the risk of any bad loans to Wall Street. The Wall Street repackagers then transfer the bad-loan risk to their rich investors, drawing even fatter fees. These investor elites get phenomenal yields on the IOUs, then plant their profits in tax-free havens like the Cayman Islands.

It's a brilliant Ponzi scheme ... as long as all those Mr. and Ms. Subprimes keep putting their little dabs of cash into it every month. Oops! There's the rub.