THE BROOKLYN RAIL
CRITICAL PERSPECTIVES ON ARTS, POLITICS AND CULTURE

Subprime Crimes From Wall Street to Brooklyn and Beyond

by Nicholas Jahr

March 2008

It starts with someone like Milagros Munoz. She has lived in East New York for nearly all of her 46 years. When her mortgage broker first showed Munoz, a dental assistant, the brick duplex a short walk away from the clinic where she works, she thought she'd finally found a home for her family. "When I did the closing," she says, "instead of being happy… like some people, they're ecstatic, they wanna pop the champagne and say 'Look, I got a house!'…all I did was cry, I said, 'Mom, I don't feel right…something's wrong.'"

She didn't know it yet, but Milagros had been burned by an "Exploding ARM," or Adjustable Rate Mortgage. ARMs start off with low interest rates that "reset" after two years, shooting up dramatically over the remaining 28 years of the loan. Overnight, Munoz's monthly mortgage payment increased by $700. Even though she rents out the bottom floor of her duplex, "there's no way in this world I can catch up," she says.

Exploding ARMs are only the most common form of what we're now familiar with as subprime mortgages. While rates of subprime lending (a type of predatory lending) have begun dropping across the country after reaching unprecedented highs in 2006, NYC still has one of the highest rates around. Last year, a record-shattering 18,000 families in the city were threatened with foreclosure.

Munoz was taken in by a "one-stop shop," in which the mortgage broker, the real estate agent, and the appraiser—parties which usually serve as checks and balances on each other—work together, for the customer's convenience, of course. "Once you sign that contract, it's on you," Munoz says. "You know: if you didn't see it, you didn't know—that's your tough luck. That's the shame on me." But of all those involved in arranging the loans, she asks, "What happens to those people? They know better than me."

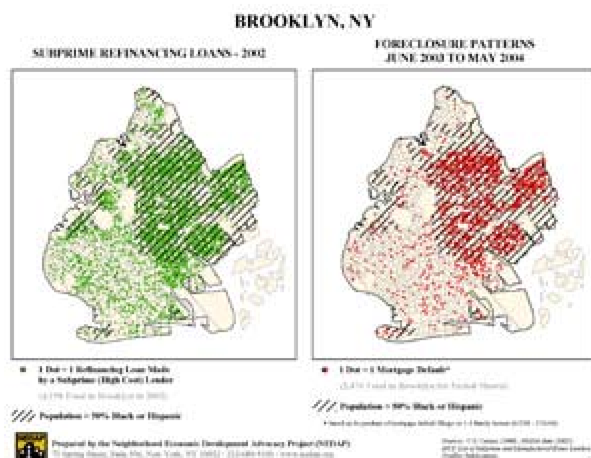
Her broker certainly knew that Munoz couldn't afford the house; at the time, she was making less than $30,000 a year. Her loan application lists her income as $65,000. "I didn't know anything about it," she says. "I'm doing the right thing; I want to buy my house, I want to make my payments on time and everything. They knew that eventually,

Milagros is not going to make that mortgage payment. She's gonna lose it, and we're going to grab it back. They knew. They just knew."

What exactly defines subprime mortgages is a subject of some debate. In his 2007 book *Subprime Mortgages: America's Latest Boom and Bust*, former Federal Reserve member Edward Gramlich defines them simply as "loans to borrowers who do not qualify for the prime mortgage rate" (usually a "fixed" or unchanging rate typically paid off over a 30-year period). Many critics reject this definition, particularly because borrowers who qualify for "prime" loans are often steered toward subprime loans.

In addition to exploding ARMs, the subprime lender's arsenal also includes "option ARMs," which among other features grant borrowers the "option" of a minimum monthly payment that doesn't even cover the interest on the mortgage (unpaid interest is then quietly tacked on to the principal); "no doc" loans, made even though no documentation is given to verify the borrower's income (currently around 50% of subprime loans); and even prepayment penalties, which are exactly what they sound like: financial penalties for paying your mortgage off early. Prepayment penalties are particularly insidious, essentially trapping borrowers in their loans—80% of subprime mortgages include prepayment penalties, as opposed to 2% of prime mortgages.

The stats are staggering. The Center for Responsible Lending reports that 7.2 million families now hold subprime mortgages. As a rule of thumb, one in eight (13%) of subprime mortgages ended in foreclosure inside of five years. The CRL projects one in five of the subprime loans made over the last two years will follow suit. 2.2 million homeowners with subprime mortgages have either already lost their homes or will do so in the next two-three years. Way back in '94, subprime mortgages accounted for a mere $35 billion, less than 5% of new mortgages. By 2005, they'd hit $665 billion. When considered in terms of value (as opposed to as a percentage of new mortgages), subprime loans accounted for 20% of the mortgage market in 2006. What happened? Why did such a perverse form of lending—loaning money to people who didn't have a hope of paying it back—take off?



In his book, Gramlich—a Democratic appointee to the Fed whose warnings to Chairman Alan Greenspan about the subprime market were ignored—traces the beginnings of the subprime boom to the repeal of laws prohibiting usury (or charging unfair interest) amid the deregulatory frenzy of the Reagan era. Up until that time, federal and state law had limited just how much lenders could charge borrowers. No repeal, no subprime loans: case closed.

But even Gramlich's own data show that subprime lending didn't really pick up speed until 1999. In the wake of 9/11 and the dot-com crash, Greenspan stomped on the gas, dropping the Federal Reserve's interest rate to historic lows. (Think of the Fed rate as essentially setting the price of money; the lower it is, the more freely banks dole out cash, the easier money is to come by.) "That was the flint" that set off the boom, says Josh Bivens of the Economic Policy Institute. Now lenders could offer unheard-of rates to make owning a home affordable. At least at first.

Money flooded the housing market. One study by the Center for American Progress determined that "spending on new homes and home renovations contributed relatively more to economic growth than at any point since the 1950s." For the first time in a century, home prices left both inflation and rental prices in the dust. As Bivens points out, homeowners took advantage of the superheated market by borrowing against their homes, essentially pumping up their disposable income every quarter between 2001 and 2007. Without this stimulus, the economic growth the country saw in the two years between September 2004 and 2006 wouldn't even have occurred.

Similarly, while job creation under the Bush administration has consistently fallen short of the numbers needed just to keep pace with population growth, one of the few reliable sources of new jobs has been construction and housing-related work. Between March 2001 and March 2006, that was where 69% of all new jobs in the private sector were found. The housing boom was the engine of the Bush economy.

While the 20% of the mortgage market represented by subprime debt was a crucial spur to demand, the fuel for the subprime mortgage boom really came from investment banks like Goldman Sachs. What these banks figured out was that given the regular income stream supplied by mortgage payment, and the high returns of subprime mortgages, they could place large numbers of subprime mortgages in a trust, and then issue securities based on the holdings of the trust. Packaging the subprime loans with other debt enabled the banks to declare these securities less risky than they actually were. Investors purchased the securities, and the banks walked away with hundreds of billions in profits.

The banks "were actually actively soliciting different types of loans that weren't viable," says Josh Zinner, Co-Director of the Neighborhood Economic Development Advocacy Project (NEDAP), which has been calling for action on predatory lending in New York for more than a decade. According to Zinner, these were "loans that, if you were a traditional lender, you'd never make." Whether those loans were affordable or not, the investment banks knew they'd turn a profit. "So they're not just buying these loans, but they're actively pushing the mortgage lenders to make more and more of them." And

there was no incentive to make the loans affordable. With the investment banks promptly passing the loans off to investors as securities, ultimately no one "owned" the loan, much less the risk that the borrower would default. Zinner and other advocates refer to this as "mortgage laundering." In a tellingly perverse irony, the banks called it "securitization."

Essentially it was an elaborate pyramid scheme. The *New York Times* even reported rumors that the same loans turned up in more than one trust. According to *Wall Street and the Making of the Subprime Disaster*, a report released last November by several advocacy groups, ten investment banks—including Goldman Sachs; Lehman Brothers; Morgan Stanley; and Deutsche Bank—underwrote 70% of the $486 billion in securities based on subprime mortgages in 2006. By the end of 2006, there was $6.5 trillion in securitized mortgage debt. These banks made the market. "The industry made a killing off of these loans for years," says Zinner, "particularly the investment banks and Wall Street. They made a killing knowingly purchasing unsustainable, unaffordable loans and securitizing them."

Last April the third largest subprime lender in the U.S. filed for bankruptcy as its borrowers defaulted *en masse*. More lenders followed suit. By early August, the French bank BNP Paribas could no longer figure out how much the securities held by three of its investment funds held were worth; with two billion euros at stake, the funds were suspended from trading. Securitization really meant metastasis.

In mid-September, the BBC broke the news that the Bank of England had taken the rare step of granting a request for financial support by the UK's fifth largest mortgage lender. What followed was England's first bank run in a century. Since then the losses have mounted, with 16 of the world's largest financial institutions racking up more than $80 billion in losses. Banks became reluctant to lend to one another, and credit evaporated. This past January, the Fed made its largest rate cut in a quarter century. And then it cut the rate again. At the end of the month, building activity took its biggest fall in 25 years.

In excruciating slow motion, the global economy seems to be lurching toward a halt.

Before you assume this is a crisis confined to the city's poorer corners, take a walk over to Fiske Place. Tucked away between Carroll and Garfield Streets in Park Slope, it's been home to Karen V.M. Smith for 12 years. In the parlor where we sit down to talk, reproductions of Degas' dancers are hung alongside sidewalk Africana. Smith lives in an eight unit co-op; after she moved in, she bought out one unit after another until she owned the entire building. It took seven years and all the fiscal acumen she'd learned working in sales for Chase Bank.

"It was 9/11," she says. "People left, completely." Smith found herself scrambling to find steady tenants and to bring the empty units up to snuff. One loan led to another. Soon she had a five-year ARM, with an automatic extension for another five years. "I was drowning," she recalls. Smith's broker eventually pointed her toward a lender that offered her a one-year loan of $170,000, with monthly interest payments of 12%. "I didn't have it then; I didn't have it in the middle; I didn't have it in the end," Smith says. "I really

wanted to believe, in the end, maybe, if push came to shove, I would find that money." Her most recent appeal of the foreclosure was dismissed on February 5.

Like Munoz, Smith fits the profile: data from NYU's Furman Center show that across NYC, subprime lending is all too predictably highest to Blacks (40.7% of all subprime loans in the city in 2006) followed by Hispanics (28.6%). Although it's the Bronx that has been hit hardest in the city, Brooklyn has the dubious distinction of being home to 5 of the 10 neighborhoods with the highest rates of subprime lending, all of them majority minority: East Flatbush, Ocean Hill/Brownsville, East New York, Bushwick, and Bed-Stuy. Despite this, Karen doesn't think race was exclusively to blame for her treatment (nor does she think being a single mother who looks younger than her 40 years helped): "I knew it was coming, I knew how it was coming, and I went in."

"It's not the borrower who was risky," says Mark Winston Griffith, "it's the product that was risky, and the way it was used." Winston Griffith, Senior Fellow for economic justice at the Drum Major Institute, was Josh Zinner's predecessor at NEDAP, and before his time there he ran the Central Brooklyn Federal Credit Union. "If you have a pattern of loans that are going bad," he observes, "it's not because the borrowers were risky in the first place—it's because you didn't do what was necessary to structure the loan in such a way so that they could pay you back. That's exactly what happened here. These products were, in some ways, designed to fail. It's the loan itself that's subprime, not the borrower that's subprime."

Greenspan, of course, insisted subprime lending was the "democratization of credit," allowing minority borrowers to finally break into the ranks of homeowners. "Most of us believed that was bullshit," Winston Griffith argues. "It was really all about enabling… people to get paid. And it was just assumed that if you were a subprime borrower, you deserve what you get. No one asked you to take out this loan; no one asked you to take it out under such abusive terms. You should've known better. Borrower beware."

Karen Smith's teenage son David lives with her on the weekends, but she keeps her door open to him and his cousins throughout the week. "Before I would be panicking every time my mom would bring it up," David says. He's adopted some of his mother's cheerful stoicism over the last 18 months, but he'd be sorry to leave Park Slope: "I love this neighborhood. It's just… it's freedom," he says. "You can walk around in the street with your iPod out. But if you're in Bed-Stuy, you can't do that; you'll get robbed. Easily." But the Smiths refuse to leave their home without a fight. "Oh, I plan to chain myself to the front gate," his mom says with a laugh. David doesn't miss a beat: "If you do that, I'll be right next to you."

Lionel Ouellette is the sort of organizer who would supply the chain. He's the executive director of CHANGER (Communities, Homeowners and Neighbors Gaining Economic Rights), a small grassroots group which currently counts 35 families as members, and around 50 more people who they can count on to participate when they stage an action.

Back in November, I watched Ouellette try to muscle his way past Goldman Sachs' doorman in an attempt to deliver a letter to the investment bank's CEO. In December, CHANGER rallied outside a new branch of Washington Mutual, and actually convinced one local politician not to speak at the opening that day. "We're in their face and we're gonna get in their face until they take responsibility for it," says Ouellette.

"Our organizing is about taking someone who was a victim and moving towards becoming a survivor, and claiming their power," Ouellette tells me. "A lot of people are really blaming themselves. 'I did something wrong, it's my fault.'" Focus groups conducted for a CUNY study confirm Ouellette's observation; homeowners saw their situation as one they were responsible for, or one that they had no control over—and not first and foremost as one in which they were exploited. Struggling with the sense of responsibility that at times both Karen Smith and Milagros Munoz express makes it that much harder to take action. In Ouellette's words, CHANGER encourages borrowers seeking help to retell their story, as a way to get them "moving past all that pain… to a place of power. As people start to understand, 'How did I get approved for a $500,000 loan when I make $35,000 a year?'"

Ouellette has his own story to tell: in 2001 he and a few friends were looking for an apartment in Sunset Park when they realized that once they'd paid first, last, and two months rent up front, they might as well buy a house (a cousin had done just that). They went with United Homes, yet another one-stop shop. "They owned the company, they owned the real estate agent, we used their lawyer, we used their appraiser, inspector, everything…stupid. We were very stupid." Although he and his friends were able to keep the house, Lionel started organizing around predatory lending not long afterwards.

"They make you an activist," Munoz told me when we first met at that same rally out in front of Goldman Sachs in November. "There's a lot of people who hide; they feel guilty and ashamed," she told me later. "I'm not ashamed. I didn't do anything wrong. I did what I was supposed to do." She vows to continue fighting. "I have to speak out for the people who are ashamed, because you can't be ashamed; it was not your fault. They're in the wrong, not us."

Munoz lives off Pitkin Avenue, which takes its name from Colonel John R. Pitkin. The Colonel arrived in what was then quiet farmland in 1835, snapped up 135 acres worth, built a factory, and dubbed it East New York. In two years he'd gone bust, but the name stuck. These days the avenue that bears his name is a stretch of storefront salvation and desecrated lots. No less than four such lots are strewn about Munoz's block. This is the legacy of the last wave of flight and blight, from which East New York has slowly—and advocates would say successfully—been struggling to recover.

"All the neighborhoods where you see the subprime crisis hit the hardest are generally areas which were the targets of redlining in the past," explains Mark Winston Griffith. "Banks decided they really would not do business, or could not do business, or felt like it was too risky to do business," In neighborhoods like East New York, he says. "The subprime crisis is really just a natural outgrowth of that." Communities starved for credit

were easy prey for subprime lenders, which were in turn often subsidiaries of, or purchased by, the very banks that had cut those communities off decades earlier.

Mike Gecan is an old-school organizer with East Brooklyn Congregations. He's been working in the neighborhood since 1980. The sort of lending that brought about the subprime crisis has "been going on for four decades—it's just the latest version of it."

When black and Puerto Rican families first moved to East New York, private mortgage brokers offered them "purchase money mortgages," which came with higher interest rates and allowed them to make lower down payments. The subprime phenomenon is not as new as it may seem.

"This was a neighborhood that lead the rebuilding of New York, and was proud of it," Gecan says. New York ACORN was born in East New York in the '80s. Whether the subprime crisis will repeat the destruction of the foreclosure epidemic of that period remains to be seen. For the time being, vacancy rates remain low in New York, which means that while foreclosures may increase, homes aren't left empty. Gecan thinks the crisis will have "a terrible impact on a significant number of families," but that it won't tear apart the fabric of the neighborhood. Other cities will be far worse off.

Still, disturbing signs continue to mount. South Brooklyn Legal Services has been overwhelmed by calls to its hotline; they were compelled to shut the line down for the first time this past summer, and have had to do so again several times since. One study projects New York City will suffer the largest loss of gross metropolitan product (GMP) in the country (with predictable results for taxes and services), or more than $10 billion. Los Angeles: $8 billion in GMP lost. In Clark County, Nevada (which includes Las Vegas, the last honest city), nearly one in 20 homes are in foreclosure. In Cleveland, "the subprime capital," one in eight homeowners will face eviction in '08. Baltimore has seen 33,000 foreclosures since 2000. The cities are dying, and we can't say we don't know why.

The question, as ever, is: what is to be done? Legislators are scrambling to propose solutions to the crisis, but so far the results remain sparse. Ouellette isn't holding his breath: "No law that's going to stop these things from happening can be passed." In 2002, Ouellette was one of many advocates lobbying hard for the city council to pass anti-predatory lending legislation. When it passed, they were ecstatic—only to see Mayor Bloomberg veto it. When the city council overruled his veto, Bloomberg sued the council, arguing that it lacked jurisdiction. Ultimately, the New York State Supreme Court struck down the law.

"On both sides," observes Lionel, "Republican and Democrat, presidential candidates: the number one funder for them is banks." He's not far from the mark. According to the Center for Responsive Politics, Hillary Clinton has taken $905,861 from Goldman Sachs and Lehman Brothers alone, over $6 million from the securities & investment industry, and another $5 million from real estate interests for good measure. The Center ranks them as some of the most powerful interests backing her candidacy. Obama has given her

a run for the money, taking in $672,393 from Goldman and Lehman, $5.5 million from securities & investment firms, and $2.8 million from the real estate industry.

Turning to the local level, while fundraising for the 2009 mayoral race has yet to begin in earnest, Congressman Anthony Weiner—the only Democrat to have officially declared he's running—has already raised just under $3.6 million. Only $2,000 of that comes from employees of Goldman and Morgan Stanley, however. There's some reason to hope that the city's strict limits on corporate contributions may help check the interests involved in the subprime crisis at this crucial moment. With that in mind, City Council Speaker (and certain candidate) Christine Quinn has raised $6,770 from the *troika* of Goldman, Morgan Stanley, and Lehman; while the third most likely contender, City Comptroller Bill Thompson, has raked in $16,950.

Before we assume a direct line of influence, it's worth noting the Senator Chris Dodd, darling of the financial industry, has proposed what most advocates agree is the strongest legislation yet to see the light. Dodd has called for a $20 billion pool of capital that could be used to buy up and renegotiate subprime borrowers' loans. He has also sponsored legislation that would redefine what constitutes a high-cost mortgage to include most subprime loans; prohibit prepayment penalties; require that lenders document the ability of the borrower to repay the loan; and, most important, hold those who purchase loans from lenders liable for the terms of the loan itself. Trusts would no longer shield the financial interests from accountability. Still, "I don't think that that is necessarily justice," NEDAP's Josh Zinner says. The investment banks "have created huge problems in the economy and a lot of people are going to suffer. The process needs to begin at least in which they're held accountable; at this point they're not even in the discussion. In terms of the debt that they need to pay to society to try to make this situation whole, that's not even discussed yet."

While the city has recently committed $5 million to a new Center for New York City neighborhoods (one of the most significant efforts of its kind in the country, which will dramatically expand financial counseling services), most of the proposals currently on the table are aimed at preventing future bad loans. What's desperately needed is remedial aid for Milagros Munoz, Karen Smith, and the millions of homeowners like them who are already in trouble, in Brooklyn and across the country. They were caught up in a scam of epic proportions, one that was absolutely essential to keeping the economy afloat for eight years. Justice requires finding a way for Munoz, Smith, and everyone else caught in the subprime trap to keep their homes.

This document is provided for "fair use" not-for-profit, educational purposes (and other related purposes). If you wish to use this copyrighted material for purposes of your own that go beyond "fair use," you must obtain permission from the copyright owner.