

Bush unveils subprime mortgage scheme to bail out banks

By Barry Grey
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The plan announced by President Bush Thursday to freeze interest rates on some subprime mortgage loans will do nothing to stave off foreclosure for the vast majority of families facing the loss of their homes in the coming months.

Bush, flanked by Treasury Secretary Henry Paulson, Housing and Urban Development Secretary Alphonso Jackson, a Federal Reserve Board governor and other federal regulators, announced the plan at a White House press conference only hours after the Mortgage Bankers Association reported that the number of US homes in foreclosure rose to a record level in the third quarter, engulfing 1.7 percent of homes. The number of delinquent mortgages rose to 5.6 percent.

Worked out between Treasury Secretary Henry Paulson and major Wall Street banks, mortgage lenders and servicers, and investment funds holding securities backed by subprime loans, the overarching aim of the Bush administration plan is to limit the losses suffered by financial giants from the meltdown of the US housing market and resulting credit crisis.

It is estimated that 1.5 million adjustable-rate subprime mortgages, totaling some \$400 billion, will reset to higher interest rates over the next 18 months, resulting in the foreclosure of hundreds of thousands of homes and further destabilizing some of the biggest US banks, mutual funds, insurance companies and hedge funds, which hold hundreds of billions in so-called “collateralized debt obligations” (CDOs) backed by bundles of subprime loans.

The US housing meltdown has already forced such banking giants as Citigroup and Merrill Lynch to write off tens of billions of dollars in high-risk speculative investments linked to subprime mortgages. The collapse of these inflated assets has eroded confidence in the financial system and produced a credit crunch that has virtually halted US economic growth and threatens to plunge the American economy into a sharp recession.

The crisis is poised to intensify as the subprime foreclosure rate, already at 10 percent, spirals higher when the bulk of interest rate resets take effect. It is the crisis on Wall Street, not concern for the plight of millions of families overwhelmed by debt, that has precipitated the intervention of the Bush administration.

Under the administration plan, mortgage lenders will voluntarily freeze interest rates for a minority of subprime adjustable-rate borrowers for five years at the entry level—already several percentage points above the interest rates for conventional home loans. Only those subprime borrowers who have kept up with their payments and are deemed able to continue paying the “starter” rate, but unable to sustain the higher rate slated to kick in over the coming months, will be eligible for the freeze.

Subprime borrowers deemed able to pay the higher reset rate, and those considered unable to continue paying the initial, lower

rate, will be excluded. This means that the vast majority of low- and middle-income homeowners struggling to meet their mortgage payments and hold onto their homes will receive no relief.

Office of Thrift Supervision Director John Reich said earlier this week that the plan could help “tens of thousands” of homeowners—out of the hundreds of thousands, if not millions, who face being thrown onto the street. At the Thursday press conference, Paulson stressed, in response to a reporter’s question, that the Bush administration plan would merely “streamline” the process of mortgage adjustments already being carried out by mortgage lenders seeking to stanch their losses from failed home loans.

The plan applies to loans made between January 1, 2005 and July 31, 2007 which are scheduled to reset between January 1, 2008 and July 31, 2010. That automatically excludes \$85 billion in these mortgages that are resetting in the final quarter of 2007.

Another aspect of the scheme is a speedup of refinancings through the Federal Housing Administration for subprime borrowers who have built up equity in their homes, and a loosening of regulations to allow state and local governments to issue tax-exempt bonds to fund refinancings.

While this plan will do little to limit the social disaster facing working class families, communities blighted by vacant homes, and state and local governments deprived of real estate taxes, the politicians and bankers hope that it will be sufficient to stem the erosion of confidence in the credit system and buy time for Wall Street to avert a catastrophic collapse. It will have the immediate benefit of enabling the banks and investment houses to delay writing down billions in bad investments.

Treasury Secretary Paulson first announced the plan on Monday at a housing forum sponsored by the Office of Thrift Supervision in Washington. Paulson’s terminology made clear the narrow parameters of the relief being offered to distressed homeowners. He spoke of avoiding “preventable” foreclosures and aiding “able” and “financially responsible” homeowners.

Speaking of the most distressed subprime homeowners who have not been able to keep up with their “starter rate” payments and are therefore ineligible for the proposed rate freeze, he acknowledged that some would “become renters again”—meaning they would be forced out of their homes.

At one point he read out a toll-free telephone number for struggling subprime borrowers to call, and then quipped that he doubted anyone in the forum audience would be calling the number—a joke that evoked guffaws from his listeners.

This aside was significant. It highlighted the fact that the government-business consortium, which calls itself “Hope Now Alliance,” is entirely a creature of the US financial oligarchy. Paulson himself was chairman and CEO of Goldman Sachs before becoming Bush’s treasury secretary in July of 2006. An assistant to John Ehrlichman in the Nixon administration, Paulson joined Goldman Sachs in 1974. His net worth is estimated at \$700

million.

Those with whom Paulson, the Federal Reserve Board and other regulatory officials have been meeting to thrash out differences and reach agreement on the terms of the subprime scheme—top executives from Citigroup, JPMorgan Chase, Wells Fargo, Washington Mutual, Countrywide Financial, the American Securitization Forum—bear primary responsibility for the housing meltdown and widening economic slump, which were the inevitable outcome of their own reckless and shortsighted policies.

They all have a vested interest in shielding the financial establishment from the full consequences—including possible criminal sanctions—of years of rampant speculation and accounting manipulations that concealed the enormous levels of risk and inflated values behind the huge profits and staggering salaries reaped by Wall Street executives.

Speculation and fraud

Bush, Paulson and company place the onus for home foreclosures on “irresponsible” borrowers, but the real estate and credit bubbles that have now burst, victimizing millions of working class and middle class families, were intimately bound up with fraudulent and predatory lending practices that were encouraged by the biggest US banks and investment houses.

The *New York Times* reported on Thursday that Paulson’s former firm, Goldman Sachs, began unloading its mortgages and mortgage-backed securities late last year when subprime defaults began to soar. But the top investment bank continued to package and sell securities backed by subprime mortgages, marketing \$6 billion worth of these securities in the first nine months of 2007.

The *Wall Street Journal* on December 3 published a front-page analysis of the over \$2.5 trillion in subprime loans made since 2000 showing that “as the number of subprime loans mushroomed, an increasing proportion of them went to people with credit scores high enough to often qualify for conventional loans with far better terms.”

The study, carried out for the *Journal* by the San Francisco research firm First American LoanPerformance, said that 55 percent of all subprime loans in 2005, the peak year of the subprime boom, went to borrowers who met the qualifications for lower-interest conventional mortgages. The proportion rose even higher by the end of 2006, to 61 percent.

The basic reason is that the mortgage industry rewarded brokers for persuading borrowers to take a loan with an interest rate higher than that for which the borrower qualified. “On average,” the *Journal* reported, “US mortgage brokers collected 1.88 percent of the loan amount for originating a subprime loan, compared to 1.48 percent for conforming [conventional] loans, according to Wholesale Access, a mortgage research firm.”

Those who were hustled into taking a subprime adjustable-rate mortgage were assured that they would be able to refinance their loans before the reset rates—generally 30 percent higher—kicked in two or three years later because the market values of their homes would have significantly risen in the interim. But the collapse of the housing market and sharp decline in home

prices has left many of these borrowers owing more than their homes are now worth.

In addition to the financial crisis, politics figures into the administration’s show of concern for distressed homeowners. The economy and the social crisis are increasingly coming to the fore as an election issue according to opinion polls, and the two states with the highest foreclosure rates—Florida and Ohio—are considered battleground states in the 2008 presidential contest.

The Democrats are likewise seeking to gain political advantage from the mushrooming foreclosure crisis. Senator Hillary Clinton, the front-runner for the Democratic presidential nomination, this week issued a statement that barely went beyond the minimal measures in the administration’s plan. In addition to a five-year freeze on subprime interest rates, she called for a 90-day moratorium on home foreclosures.

This will only marginally delay the coming avalanche in foreclosures, while giving the banks some breathing space to contain the meltdown in CDOs and other exotic securities. Clinton appeared at Nasdaq headquarters in New York on Wednesday and spoke before an audience of finance industry executives, whom she chided for their role in the housing meltdown.

This type of posturing is aimed at duping the public, while the politicians of both parties shield the Wall Street firms and multi-millionaire executives who have further enriched themselves by promoting high-interest home loans and engaging in other predatory policies.

None of the major Democratic presidential contenders or congressional leaders is calling for serious investigations, including criminal probes, into the subprime crisis. No serious congressional investigation has been launched. There are no calls for a large-scale emergency allocation of public funds to enable working class and middle class homeowners to keep their homes, something that could be paid for simply by rescinding the more than \$1 trillion tax cut for the rich enacted by Bush with Democratic support or ending the war in Iraq, which consumes billions of dollars every month.

The fact is neither party will propose any measures that seriously impinge on the vast fortunes and prerogatives of the financial elite, to whom the Democrats, no less than the Republicans, are beholden.

The mounting social crisis is the product of the increasingly parasitic and corrupt character of the capitalist system in the US and internationally. Millions of American families are being thrown into conditions approaching destitution as a result of the anarchy of the market and the mad profit frenzy on Wall Street, which have fueled an ever greater concentration of wealth at the very top of society.

There can be no progressive solution to the housing crisis outside of an independent political struggle of the working class that directly challenges the entrenched power of Wall Street and advances a socialist program for restructuring the economy along democratic and egalitarian lines. This must include the transformation of the banking and housing industries into publicly-owned and democratically run entities, functioning as part of a planned economy geared to the common good, not corporate profit and the further enrichment of the corporate-financial elite.