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Adam Poyner
Old Dominion University

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By Adam Poyner

The late 2000's financial and economic crisis created the greatest recessionary period of global economics since the Great Depression of the 1930's. Many of the world's largest financial institutions, hedge funds, and investment groups were at fault for dealing with financial derivates and mortgage-backed securities in secondary trading markets without assessing them correctly for associated risk. Conditionally, many of these mortgages were sold to individuals without verifying their income, resulting in mortgage defaults. Following the evident burst of the housing bubble in 2008, the perfect storm brewed the collapse of housing prices after countless mortgage defaults and bank bailouts.

Accordingly, the expansion of mortgage credit resulted in the gradual inflation of housing prices that led to the housing bubble burst. This expansion began primarily in the late 1990's and early 2000's where the U.S. government and its financial sector generally supported institutions lending to subprime borrowers. This was backed by both Democrats and Republicans as well as special interest groups pushing for expansion of the overall mortgage lending industry. This included the passing of legislative acts that maintained a passive approach in the mortgage lending industry, such as the Gramm-Leach Bliley Act of 1999. Since the act was posed to limit the market barriers between banking institutions, many financial conglomerates were enabled to take such leaps by buying out or conjoining finances across various industries, including real estate and mortgage lending. The federal government's failure to limit the expansionary interests of lending institutions fueled the result of the expansion of mortgage credit in the U.S. and other areas across the globe. It is believed by economists that deregulation and lack of separation for commercial banks and insurance transactions was the heaping cause of the 2008 financial crisis. According to Joseph Stiglitz, who was the former chairman of President Bill Clinton's Council of Economic Advisors and Nobel Prize winner, the result of passing bank reform laws through Congress created a "high-risk gambling mentality" amongst mortgage brokers and third-party investors.

As a response to deregulation and the growing potential of faulty lending practices in 2000, former U.S. Department of Housing and Urban Development (HUD) Secretary Andrew Cuomo developed the National Task Force on Predatory Lending. This group consisted of industry and government professionals who worked to effectively raise awareness of the fine print associated with home buying and subprime mortgage loans. These classifications were established by the task force under the authority of the Real Estate Settlement Procedures Act (RESPA) which was passed in 1974 with the intention of helping homebuyers comprehend their loans and to protect them from a loss of credit worthiness on their homes. Despite Congress' initial efforts, the subprime loan volume had already grown more than seven times its size from 1993 to 1998, according to the HUD task force report. HUD was tasked to provide some sort of regulation for a ballooning mortgage economy, but their efforts were a lost cause due to the lack of government adherence from the standards listed by loan officers and their lending institutions.

An evolution in mortgage-lending practices blossomed after the deregulation of mortgage brokers in the early 2000's. One of the most common types of subprime mortgage practices involved the designation of adjustable-rate mortgages (ARM), which are mortgages that have varying interest rates across the lifespan of the loans. These loans are made to protect their lenders from interest rate risk by allowing them to reset mortgage interest rate at their benchmarks based on overall performance in accordance with overall market conditions. With most adjustable-rate mortgages, the adjusted rate must be established correctly so that lenders and borrowers "share the risk" of interest rate changes throughout the life of the loan. Prior to the crisis, many underlying characteristics were hidden beneath the lines of these mortgages, which made up of approximately 80% of subprime mortgages during the subprime mortgage crisis. Many of these mortgages consisted of initial rates that would go on for approximately two to three years before higher variable rates would come into effect, which may range depending on the amount borrowed and the initial principal put down towards the loan. Also, certain clauses allowed the loan principal to increase over the loan length, resulting in unforeseen higher payment in the long-term. Other loans associated with adjustable-rate mortgages had a balloon payment clause, which featured smaller payments at the beginning of a loan agreement that would significantly increase into a large payment at the loan's end. On the large scale, such sources of predatory lending in the subprime mortgage market were enough to misjudge the risk associated with the interest rates of these loans in such an expansionary period of mortgage credit.

According to a report from the Joint Center for Political and Economic Studies, the target demographics of subprime mortgages in 2006 fell "disproportionately" to Hispanics and African Americans. In the study, twenty-six percent of mortgages for home purchases were subprime for White Americans, forty-seven percent were subprime for Hispanics, and fifty-five percent for African Americans. According to a study of trends on income family distributions by race and ethnicity, median family income for African Americans and Hispanics has leveled between $25,000 to $35,000 over the beginning years of the twenty-first century. It can be speculated that an increase in percentage of Black and Hispanic subprime mortgage assumptions accounts for a lack of income or creditworthiness that allows such significance in minority representation. After all, the origination of subprime lending was to target borrowers who have insufficient credit histories which are ultimately caused by payment delinquencies and judgments and are determined as an unfavorable history of loan repayments.

The primary workhorse that should have been in the control front to establish limits in predatory lending to subprime borrowers was the Federal Reserve, otherwise known as the central banking system of the United States. With the implementation of the Truth in Lending Act (TILA) of 1968 and its addition of Regulation Z in 1969, the Federal Reserve Board and its agencies assumed responsibility in foreseeing the lending practices of American institutions. Specifically relating to the subprime crisis, the imposition of Regulation Z amended TILA to include section 1204 of the Competitive Equality Banking Act of 1987 to include adjustable-rate mortgage loan disclosure requirements. In July 2008, the Fed amended Regulation Z to "protect consumers in the mortgage market from unfair, abusive, or deceptive lending and servicing practices" which included all FHA-backed subprime mortgage loans that were securitized with the mortgagor's dwelling. The lack of provision over lending and investment institutions in the recessionary crisis was evidently a cause by the failure of the Federal Reserve Board. This effect led to the growth of unfair lending practices and the bundling of mortgage-backed securities (MBS), which would eventually be repackaged into leverage-based securities that were improperly assigned with risk by firms on the larger-scale. An upscale discovery of spending was shown in the early 2000's as a result of monetary policy that was implemented to promote growth after the burst of the tech bubble during the turn of the new century. As a result of the burst, many online companies began to fail and DOW plummeted roughly 75 points, causing the

Fed to slowly raise interest rates before softly lowering them to achieve a slow recoil for returned consumer spending over the next two to three years.

Financial signaling for the upcoming subprime mortgage crisis began in 2007 when the Fed released statements intended to clarify a future shift in interest rates as a result of deteriorating financial market conditions with judgments that the “downside risks to growth have increased appreciably” according to an FOMC statement. As a result, interest rates plummeted to increase consumer spending, pushing back money into the financial institutions who incorrectly managed risks for repackaged debt and default obligations. The discounted interest rates that were implemented to precautionarily increase consumer spending ballooned the already-prevalent residential investment in the housing bubble that was increasing dramatically, per-capita, in relationship to U.S. nonresidential investments and consumer durables since the early 1990’s according to Haver Analytics.

The burst of the housing bubble resulted from the hyper-inflation of the housing market and the drop of housing prices after years of unaccounted data and inadequate financial speculation and hedging. Although financial impact results differed worldwide, the stronghold of the global economy in North America and Europe suffered the most while isolated Asian countries such as China and India, saw very little impact. The result of deregulated global investment banks improperly judging the risks of hedged securities and derivatives resulted in more complex problems to take place in the financial markets. The expansion of the future’s market within the input of newly sought-after credit-default swaps (CDS’s) topped the derivatives market to a profound $530 trillion in 2008 with $55 trillion covering the CDS’s. In comparison to the $30 trillion value of the New York Stock Exchange at the end of 2007, the result of the housing bubble burst “seeped through the entire web,” with swap holders demanding money that these financial institutions had no reserve in paying. The risk associated with these derivatives were amplified because of the reliance on mortgage-backed securities.

Initial responses by the Federal Reserve took place when they bailed out the Lehman Brothers investment bank after declaring Chapter 11 bankruptcy following a response to the loss of asset values. Since the corporation was one of the first of the major financial institutions to endeavor into the mortgage origination industry, its bad bet on large amounts of subprime mortgage securities caused the Reserve to provide an example that the assets involved in the mortgage markets can be liquidated to other financial institutions. Following subsequent events, panic expanded across various financial industries including the commercial paper market and across money market mutual funds. The Federal Reserve wanted to ensure financial players that the crisis was limited to the housing industry. To no avail, outlying sectors of banking conglomerates began to dwindle with rating agencies designating obsolete asset valuations to large housing industry backers. The national government pursued lenders to initiate steps in remediating loans to avoid the abrupt downfall of a foreclosure outbreak. This included the refinancing of pre-existing mortgage loans that exceeded the market value of the homes and the allowance of temporary tax credits to homebuyers.

The Federal Reserve lowered short-term interest rates to near zero percent by the beginning of 2009 in efforts to stimulate any sort of spending to influence the inevitable decline of the nation’s finances in credit. Relief programs were initiated on the U.S. national to purchase inadequate assets from financial institutions to restrengthen their balance sheets following to gradual deflation of the economy in 2008. President Bush signed the Troubled Asset Relief Program (TARP) in 2009 to help banks eliminate mostly collateralized debt obligations (CDOs) associated with nationwide foreclosures on mortgages and the effort to maintain damage control from further foreclosures or defaults. According to the Congressional Budget Office, the program required proper reporting of the costs of purchases and guarantees for troubled assets, information on the calculation of costs and their valuation methods, and the program's effect on the federal budget deficit and debt. After previously establishing an expenditure authorization of over $650 billion, disbursements were reduced to $431 billion by 2012, deeming successful recovery of the overall housing market in nearly half a decade.

Many banking institutions were convicted of fraudulent use on the bailout loans given to banks across the U.S. in efforts to regain from the hit on the loss of mortgage-backed securities. On the local level, Bank of the Commonwealth, which served in Hampton Roads, Virginia for over thirty years at the time, obtained TARP payments after the 2008 economic crisis. While thousands of investors, residential contractors, and first-time home buyers were left with little opportunity due to the sudden inflation of government-backed securities, the banking insiders at the Bank of the Commonwealth created a fraudulent scheme that used TARP payments to the benefit of maintaining the establishment of loans with limited security. They were able to conceal overdue loans and foreclosed property from their books with returned favors to friends of the bank who borrowed substantially from the bank and were aware of the faulty operation. Subsequently, the CEO and insiders involved with creating the scheme were charged with conspiracy to commit bank fraud and were consequently punished in the following years. Regardless, a small grace period was given to the consumers of loans at the bank for a small period before the bank transferred its accounts to Southern Bank in 2011. This particularly benefited the Hampton Roads real estate industry after the housing market collapse in comparison to other local areas across the globe.

In conclusion, interventional regulation would have slowed the rise of housing prices with predatory, subprime mortgage lending practices. Financial hedging bets from larger banking institutions would not have escalated if proper risk assessment on very risky bundles of mortgage securities had taken place. It is almost certain that economic and political officials had predicted the recession before it happened but could not produce any effect that would limit the ballooning of the housing industry. The U.S. government and Federal Reserve could do nothing but bailout banks and promote consumer spending to the best of their ability after the housing bubble burst.

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