

## **Subprime Lending: the Rotten Core of the Current Economic Crisis**

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Sam Magavern

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Subprime lending has triggered a global financial crisis, but it remains misunderstood. Here are some basic facts, culled from an upcoming report on abandoned housing by the Partnership for the Public Good.

Subprime loans are high cost loans, ostensibly designed for people with less than “prime” credit. In reality, mortgage brokers and lenders often succeed in selling subprime loans to people with good credit. According to the Wall Street Journal, by 2006, fully 61% of subprime loans were going to people who qualified for conventional loans.

Subprime lending grew very fast: from 7% of home loans (2000) to 21% (2006), creating a \$600 billion industry. This explosion was fueled by many factors, including the deregulation of financial services, which allowed non-banks, such as mortgage companies, to lend with very little oversight. Traditional, fully-regulated banks make only 30% of subprime loans.

Subprime loans include many negative features beyond high rates and fees. Most subprime loans in recent years have come with low teaser rates that reset into expensive adjustable rates after two years. About 70% include prepayment penalties that trap borrowers in the loans and prevent them from refinancing affordably if they discover they’ve been duped. They have been marketed with intensive advertising and high-pressure, often fraudulent, sales techniques designed to prey on elderly and other vulnerable homeowners. Many lenders have broken even today’s lax lending laws. Ameriquest paid \$325 million, and Household International paid \$484 million, to settle predatory lending lawsuits.

Most importantly, subprime lending was never about expanding access to homeownership. Only 38% of subprime loans are for home purchase, and only 9% go to first time homebuyers. The rest are home equity loans and refinancings. What are home equity loans used for? In 2004, 58% went for home improvements and personal spending, and 27% went to pay off credit card debt.

Essentially, Americans are pawning their houses: using them as collateral for expensive, high-risk loans. Thus, subprime lending has *decreased* homeownership by leading to foreclosures. Homeownership rates for the bottom two fifths of the income scale dropped from 45.4% (1980) to 42.4% (2005). The Center for Responsible Lending (CRL) estimates that one out of five subprime loans made in 2006 will end in foreclosure. CRL calculates that subprime lending has created a net loss of one million homeowners.

Buffalo has not escaped the subprime debacle. A 2008 federal study found 9,080 subprime loans in western New York, of which 22% were overdue, 5.5% were in foreclosure, and 1.9% had been foreclosed. CRL predicts that 15.6% of the subprime loans made in the Buffalo area in 2006 will end in foreclosure.

As the government attempts to repair the credit system, it must begin to regulate subprime lenders just as it regulates banks, and it must strictly limit the ability of lenders to sell credit on unaffordable and exploitative terms.

*Sam Magavern teaches in the Affordable Housing Clinic at the University at the Buffalo Law School and is one of the founders of the Partnership for the Public Good.*