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Bad-credit and bad-faith banking ignited the housing crisis, according to Charles Ferguson's 2010 Academy Award-winning "best documentary."

3 Subprime CRISIS

by Trevor Page

I had always wanted the 'American Dream' of owning a house and raising a family," said Ray, a former Boise homeowner who wished to remain anonymous. But Ray's dream turned into a nightmare just a few years after he purchased his first house. "The money was so easy to get and I had a good job at the time. When my rates changed I found that I could barely afford to pay my house payments, but I managed to do it. When the market began to collapse, I lost my job. I had to take money out of savings just to make my house payment. My funds were starting to dry up and I had to make a choice," he said. After \$37,000 in house payments, Ray still owed more on the house than it was worth. He found a job and tried to work with his bank. When that didn't pan out, Ray made a very hard choice. "I decided it was time to walk away and take a loss on my home."

Ray's story is a familiar one in Ada County, where the Great Recession, triggered partially by the housing debacle, hit especially hard. It only takes a short trip across the county to see many new housing developments now

stalled by the economic turndown. Eagle and Meridian have unfinished subdivisions within their city limits. Developments like Avimore and the Legacy subdivisions of Eagle have not lived up to their promise.

“While not the sole reason for the housing collapse, loose lending practices like Ray experienced skewed the market and had a profound effect on the eventual crash. In Ada County, for example, when houses reached their highest prices in mid-2006, between 800–1,100 sold each month. By mid-2011, after the recession took its toll, sales dropped to between 500–600 per month and the median price of a house fell almost \$100,000.

Subprime loans were given to potential homebuyers with patchy credit or employment histories. Many individuals receiving the loans didn’t have the proper income to make the payments or didn’t have to show proof of income in order to obtain the loan. Many subprime loans went to individuals with a credit score of 640 or below. These types of loans were highly risky to the lending organization because repayment was unlikely. “It was a false market. Lenders would give money to anyone with a pulse. No one asked the question: ‘Can you afford this?’ For most, the answer would have been no. There was no oversight by anyone ... eventually that can’t sustain itself, and it didn’t,” said Holly Tastad-Pozel, an agent at Group One Real Estate.

Along with the rise of subprime loans, there was a rise in unregulated lenders, which economists say should have sounded an alarm to the industry that something was wrong. The large number of adjustable rate mortgages, interest-only mortgages and stated income loans are examples of unregulated lending methods. Stated income loans, also called no doc loans or, sarcastically, “liar loans,” did not require the borrower to provide documentation to substantiate the income stated on the application. In many areas of the country, especially those with the highest appreciation during the bubble days, such non-standard loans went from being almost unheard of to prevalent. The number of subprime loans rose as rising real estate values tempted lenders and buyers to take more risks. Some experts believe that Wall Street encouraged this type of behavior by bundling the loans into securities that were sold to pension funds and other institutional investors seeking high returns.

Subprime borrowing was a major reason for an increase in home ownership rates and the demand for housing during the bubble years of the mid-2000s. Nationally, the share of subprime mortgages to total originations increased from 9 percent in 1996 to 20 percent in 2006, according to *Forbes*. Subprime mortgages in 2006 accounted for approximately one-fifth of the U.S. home loan market. This demand fueled the rise of housing prices

and consumer spending, creating an unheard of increase in home values of 124 percent between 1997 and 2006. In the Treasure Valley alone, the average price for a home jumped from \$160,000 in the summer of 2001 to almost \$280,000 in the summer of 2006, according to the Intermountain Multiple Listing Service. Some homeowners took advantage of the increased property values to refinance their homes with lower interest rates or take out second mortgages against the added value to use for consumer spending. The collapse of the housing bubble brought high default rates on subprime, adjustable rate and other mortgage loans made to higher-risk borrowers with lower income or a poorer credit history than "prime" borrowers.

The subprime mortgage industry showed signs of collapse in early 2007 as foreclosure rates climbed higher than expected. As homeowners fell behind in their mortgage payments in ever-growing numbers, foreclosures continued to rise and interest rates rose to their highest level in years. These conditions left subprime lenders with huge losses and unable to finance new loans.

Ernie Menchaca, then the owner of Clearwater Mortgage Co. in Boise, explained that banks provided mortgage companies with programs they



Lenders, borrowers, underwriters, regulators, lawmakers and the central banks can all carry part of the blame for the subprime crisis.

36 down and out
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Allan R. Ansell

Realtor Holly Tastad-Pozel, a survivor of the 2008 real estate crash, said lenders were giving money to “anyone with a pulse.”

used to finance new loans. Basically, he said, these programs were structured so anyone who wanted money and had a job could get started on a loan. “However, the problem was that people were not required to show any financial statements to us and we didn’t ask for them ... the underwriters did this because we were not the ones approving the loans,” he said. “My hands were tied by the banks even if I didn’t want to originate



Allan R. Ansell

Undocumented loans may be a relic of the subprime era, but the damage they caused will last for years. Pictured: advertising for clients to occupy the Eagle Village development.

a loan for someone because I didn't feel they could afford it. The banks had so many programs that if we didn't try to get these individuals loans, we were threatened with litigation for discriminating against individuals ... were put between a rock and a hard place," he explains.

The recession thinned the number of lenders and real estate agents in Ada County. Marc Lebowitz, executive director of the Ada County Association of Realtors, said between 25-30 percent of the agents left the profession. "We started with 4,000 and we are now down to 3,000," he said. Added Tastad-Pozel: "The lenders and realtors who got through it are not just survivors; they are thrivers. There was a lot of attrition in those areas."

For Idaho homeowners, 2010 was a difficult year. More than 19,000 of them received a foreclosure filing that year, an 11 percent increase in filings from 2009 and a startling 124 percent increase from 2008. In 2010,



Optimism about the inevitable rise in housing values contributed to the lending standards that precipitated the crash.

Idaho ranked seventh in the nation in the number of foreclosure filings. By mid-2011, 37 percent of Ada County homeowners were upside down in their mortgages (meaning their home value is no longer worth more than the mortgage on the home), a 3 percent jump from 2010. Adding to the ongoing Treasure Valley housing crisis is that almost 6 percent of homeowners have little to no equity in their homes. "Many people are upside down and can't sell their house. Almost anyone who bought a house between the latter part of 2007 and early 2011 is pretty much underwater," said Lebowitz.

Subprime loans continue to cast a large shadow over the Treasure Valley market as foreclosures continue, although that rate has slowed. "As an

agent, it is hard to see how people's lives are in their house and yet they can't afford to stay. It is a very emotional thing," said Tastad-Pozel. The subprime era of undocumented loans may be over, but money is still inexpensive to borrow with interest rates low and government programs in place to help refinancing. "It is so unbelievably cheap to get money right now," said Lebowitz. That and a new wave of people moving to Idaho are creating a more healthy real estate environment. "We still have a very robust market. Volume is down, but we have a lot of people moving in," explained Lebowitz. He said that the biggest groups of buyers are between 18-36 years old and over 50. The first group is moving from rentals to their own homes, while the latter is downsizing. The age groups in the middle aren't buying new homes because they can't afford to sell their existing ones, he explained.

And today the hard-won lessons of the subprime era linger. "We learned that good sound practice can't be ignored ... that a healthy community is one in which there is reasonable economic growth and reasonable price appreciation in housing investments. We learned not to be so greedy," explained Lebowitz.

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