U.S. Mortgage Crisis Can Trigger Collapse Of the Global Casino

by Richard Freeman

The accelerating meltdown of the $1.2 trillion U.S. subprime mortgage market has triggered the loss of over a half-trillion dollars on world stock markets in the first two weeks of March; obliterated New Century Financial, the second-largest subprime mortgage lender; paralyzed the market for mortgage derivatives, threatening the $600 trillion world derivatives market; caused tens of billions of dollars of losses on hedge and mutual funds; and spread contagion to Alt-A and prime-grade mortgages, which will disintegrate the $10.2 trillion U.S. mortgage market, itself one-quarter of all U.S. credit outstanding.

The way in which this meltdown—combined with the unwinding of the yen carry trade—is now occurring, makes it manifestly clear that this disintegration was not "pre-discounted" by any market forces nor any government action. *Lyndon LaRouche was the only economist who foresaw it.* And therefore, no market or market "players" or regulators will be able to stop this financial disintegration from accelerating into systemic breakdown.

As recently as three months ago, a mortgage collapse was not a "systemic collapse risk" in anyone's assessment except LaRouche's—nor did any authority foresee or even admit as possible, the unwinding of the yen carry trade now underway. The "experts" thought that "plentiful international liquidity" would soak up losses in mortgage-backed securities as foreclosures mounted—but instead, securitization of mortgages has collapsed more than 60%. They were sure the banks could force the mortgage lenders to take the defaulting loans back; but instead, 38 of these lenders have folded up, and more of the biggest are at the brink of folding now (see box, p. 8). They thought the hedge funds and equity funds would come in and buy up this "distressed debt"; but instead, liquidity in these markets has disappeared.

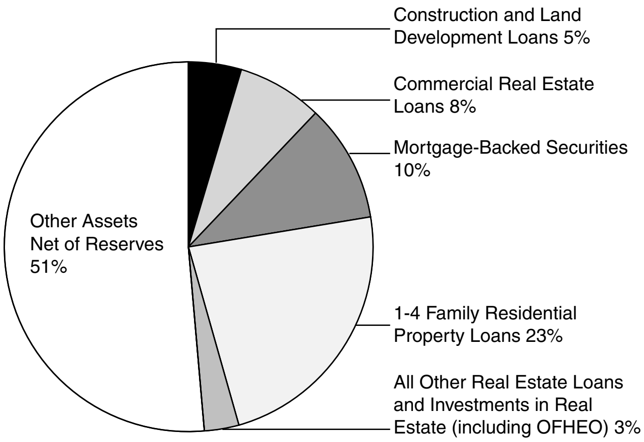
Remember that mortgage-based debt is half the assets of the entire U.S. commercial banking system (**Figure 1**).

On March 14, LaRouche pointed to the warning he issued in February 2005, of

FIGURE 1

Real Estate Assets as a Percent of U.S. Banks' and Savings & Loans' Total Assets

(Total Assets=$11.75 Trillion, Sept. 30, 2006)

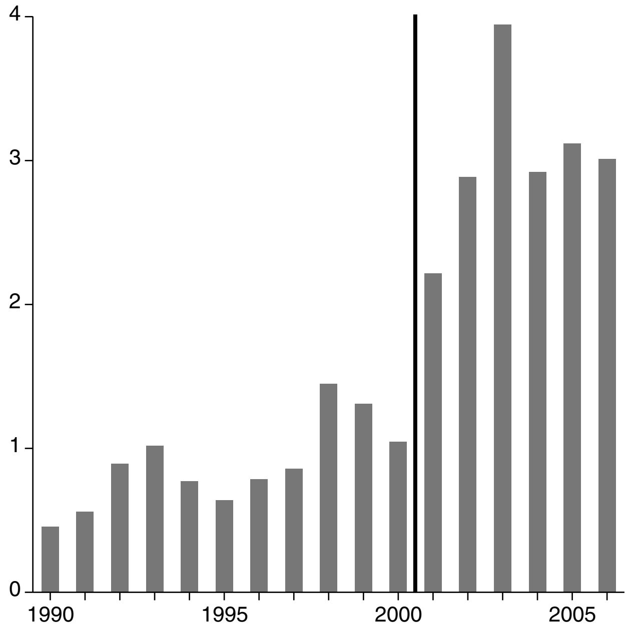


Source: U.S. Federal Deposit Insurance Corp.

FIGURE 2

Annual U.S. Single-Family Home New Mortgage Loan Originations

($ Trillions)



Sources: Office of Federal Housing Enterprise Oversight (Ofheo); *EIR*.

what a debt crisis was about to do to the globalized auto sector, most particularly GM and Ford. "The failure of the Congress to acknowledge or act on my warning then, and since, is being repeated again now," he said. "You are seeing lying and 'denial for denial's sake' from both Democratic and Republican leaders, and the expected lock-step lying by Treasury and Federal Reserve officials."

"Despite all the disclaimers you hear," LaRouche continued, "the entire financial system is coming down. What no one can determine, is the rate at which this will happen. But this much is undeniable: It can not be stopped from collapsing under present policies. I could bring this collapse under control; I know how to do it. But instead of supporting my move to do this, Administration and Congressional officials are lying and denying."

"I could bring this collapse under control," LaRouche concluded, "because I would act to change the financial system; the existing, collapsing banking system must be put into bankruptcy reorganization, and a new financial system built on initiative from the United States. My policies are effective—but so far, I'm not getting the support urgently needed from Congress, including from the 2008 candidates for President. If that continues to be the case, the entire system is coming down. And those candidates will be discredited, hated, by the Fall."

The Subprime Market

The subprime mortgage instrument has had the primary function of looting the lower 30% of the population by income bracket, to gouge out new wealth to perpetuate the housing bubble a little longer. Unlike the standard home mortgage or auto loan, which, under return to normal regulated conditions, would have a function, the subprime mortgage is mostly a criminal-type activity. It targets someone with poor credit, usually with a low income, to take out a mortgage, that, when all the costs are added in, costs anywhere from 25% to 100% more than a standard mortgage.

The subprime mortgage is the last phase of the Greenspan housing bubble, which is collapsing. After the Information Technology bubble collapsed with the crash of the Nasdaq stock index in March 2000, starting in January 2001, a shaken Greenspan built up the housing bubble to replace it. Single-mindedly, Greenspan cut the Federal Funds rate (at which banks trade overnight money) 13 times, so that by August 2003, the Federal Funds rate had bottomed at 1%, a 40-year historic low rate. This brought down mortgage rates, as intended.

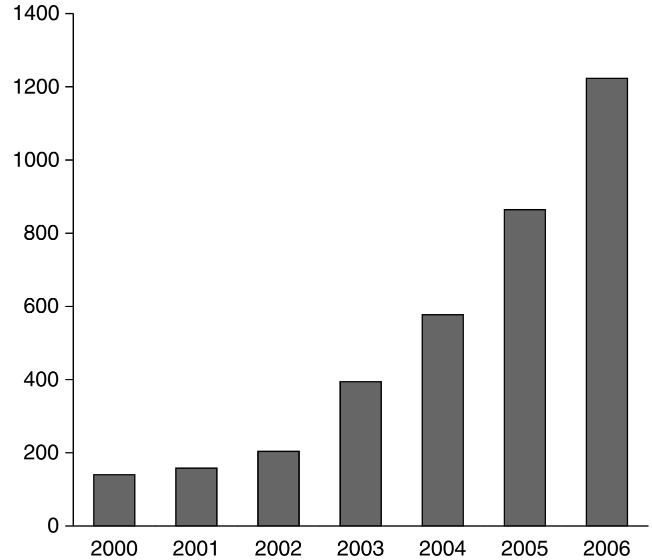
Greenspan set about pumping tremendous sums of liquidity into U.S. housing, in coordination with Fannie Mae. Accordingly, between 2001 and 2006, $15 trillion in new mortgage originations were generated, three times the level of mortgage originations in the previous five-year period (**Figure 2**). Greenspan built the biggest housing bubble in history, which allowed him to carry out two objectives. First,

TABLE 1
Percentage of Total Mortgage Loans, Which Are Subprime, by Year of Origination

2001	7%
2002	8
2003	9
2004	11
2005	14
2006	20

Sources: *B&C Lending;* Federal Reserve Bank of St. Louis; *EIR.*

FIGURE 3
Volume of Subprime Mortgages Outstanding Jumps Ninefold in Six Years
($ Billions)



Sources: Federal Reserve Board of Governors; Mortgage Bankers Association; *EIR.*

he jacked up the price of homes, in "hot" housing regions, so that bankers could attach enormous mortgages of $400,000 to $5 million to vastly overvalued properties. Bankers charged huge up-front fees, and sucked in gigantic interest-income streams.

Second, he made it possible, by a process called "cash-out refinancing," and related processes, for people to borrow against the inflated equity in their homes. *EIR* noted that in 2005, by this method, homeowners extracted approximately $750 billion in cash, a good portion of which went into consumer spending, holding up the otherwise collapsing U.S. economy. (see *EIR,* Dec. 1, 2006, "Housing Bubble's Fate, Is Banking System's Destiny.")

By 2004, Greenspan and the bankers had raked off huge sums from middle- and upper-income layers, and realized they had mined them pretty thoroughly. They would continue to scour through these groups, but they needed a new source of loot.

Next, they shifted into two areas: a) subprime mortgages, and b) exotic or alternative/non-traditional mortgages. The exotic mortgages would target all classes of the population, but with a new and dangerous twist.

It's important to remember that a house should be an affordable, decent dwelling; ultimately, a place to raise a productive and creative human being, where children are nurtured and educated. To permit this, however, there must be an adequate supply of housing, reasonably priced, for families of all incomes—something the Fed policy-makers oppose. Households that are experiencing jobs loss and pay cuts, due to globalization, simply do not have the living standard to afford usurious mortgages. This is the key real-world parameter that is the undoing of the housing bubble.

The Scam of the Subprime Mortgage

Subprime loans were made by the banks, loan-shark fashion, to low-income families, and to those with poor credit. The subprime loans were made on the same principle by which casinos are run in Las Vegas: the house always wins.

And while the subprime lending industry portrays subprime mortgages as typically having interest rates "only" two to three percentage points above prime mortgages, one study found that many subprime mortgages charge six or more percentage points above prime. In addition to high multiple fees, the subprime loan extracts a heavy penalty for late payments, and for those borrowers who *pay off their loans early,* thus keeping them locked into the loans.

When all these charges are accounted for, the subprime mortgage often is 25% to 100% more expensive than a standard prime mortgage. If a borrower defaults on a subprime mortgage, his credit rating slides, and if he is allowed to borrow again, it is on even more onerous terms.

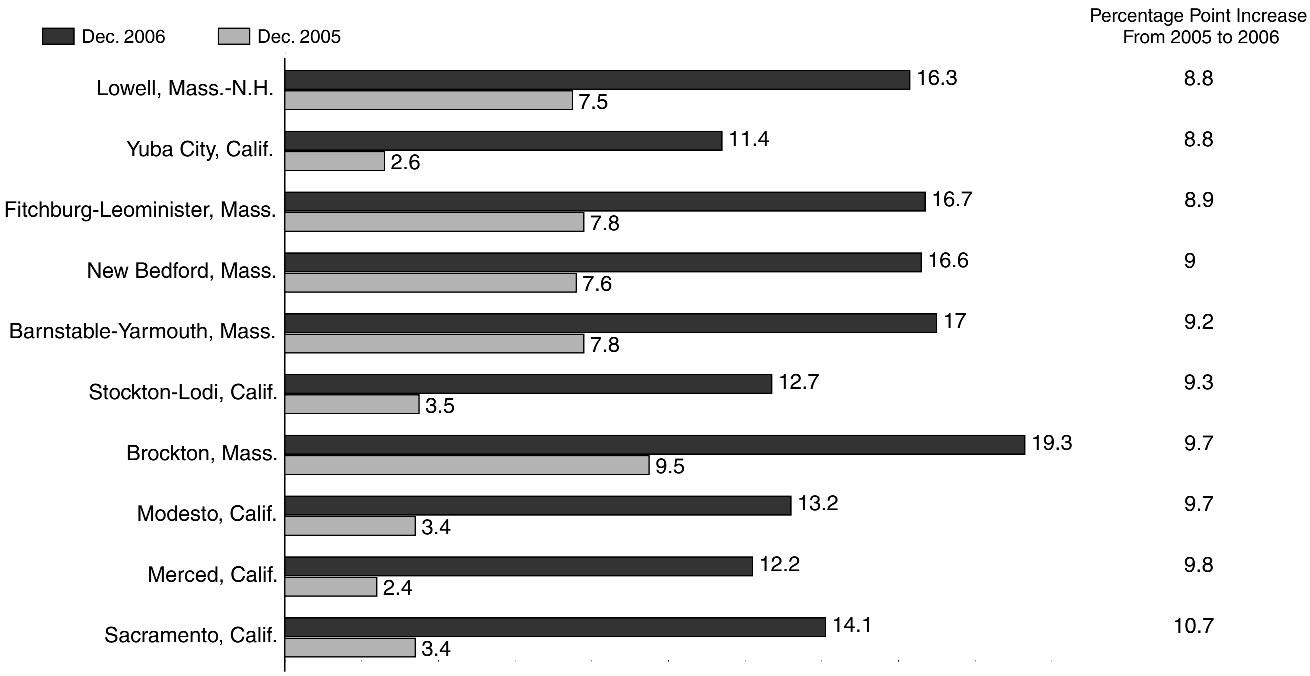
Seeing the high profits that could be sucked out of poor people, the investment and commercial banks wanted a piece of the action. For example, in 2003, the British Crown's Dope, Inc. bank, Hong Kong and Shanghai Bank (HSBC) bought Household International for $15.5 billion, and today is one of the top three U.S. subprime lenders; Morgan Stanley bought subprime mortgage underwriter Saxon for $706 million in August 2006; Merrill Lynch bought First Franklin Financial for $1.3 billion in September 2006, etc.

We'll see the aggressiveness of the Wall Street-City of London policy decision. **Table 1** indicates that between 2001 and 2004, the share of all mortgage loans made (originated)

FIGURE 4

Metropolitan Areas: Subprime Mortgage Loan Delinquencies Climb

Percent of Subprime Loans Deliquent by more than 60 Days



Sources: *Wall Street Journal*, March 12, 2007, citing First American Loan Performance figures, which were based on a sample that covers about half of all subprime loans in the market; *EIR*.

that were subprime increased from 7% to 11%. But between 2004 and 2006, it nearly doubled from 11% to 20%.

The increase in outstanding subprime mortgage loans rose from $140 billion in 2000 to $1.2 trillion in 2006, with a considerable compounding of the rate of growth from 2003 onward (**Figure 3**).

However, the loans which were premised on completely absurd assumptions, started to turn bad, especially in 2006. **Figure 4** shows that, for Sacramento, California, as a leading case, the percentage of all subprime loans that were delinquent—i.e., 60 days past due—was 3.4% in December 2005, and jumped to 14.1% in December 2006, an increase of 10.7 percentage points. This happened most dramatically in the ten cities shown on this chart, but it was a phenomenon that was occurring across the country, in every state. This served strong notice that the system was about to blow.

Exotic, Non-Traditional Loans

In parallel with subprime loans, there was a tremendous gear-up of "exotic" loans. These had many features, but two of the most prevalent were interest-only, and minimal option payment mortgages. The idea was to suck someone into taking out a much larger loan—one beyond the means of the borrower—by having him pay less initially.

- *Interest-Only Mortgage:* These are mortgages in which the home-buyer is permitted to take out the first few years of a long-term mortgage—a period of anywhere from two to five years—at a fixed, low, teaser rate of interest of 2-3%. During this initial period, the buyer pays no principal, only interest at this lower rate. When the initial period ends, the mortgage "resets," and the home-buyer must start paying principal, plus an adjustable rate of interest, which is higher than the teaser rate. This leads to a shock, as the amount of monthly payment required often jumps by 50% or more.
- *Minimal Option Payment:* This loan is even more devastating than the interest-only loan, having the additional feature that during the mortgage loan's initial period of two to five years, the borrower pays no principal, and only a *portion* of the interest. The amount of interest he does not pay is recapitalized, i.e., added onto the loan. Thus the loan amount due becomes *larger over time.*

The bankers pushed this loan with a frenzy. **Table 2** shows that exotic loans—these two types of loans combined—which accounted for 2% of all loans in 2001, zoomed to 39%. Also critical is the rate of interest from 2004 forward.

TABLE 2

Exotic Mortgage Loans* Surge as a Percent of Total Mortgage Loans Originated in That Year

Year	% of Total
2001	2%
2002	7-9
2003	11
2004	14-16
2005	31
2006, 1st Half	39

* Exotic mortgage loans consist of interest-only mortgages and option payment mortgages, combined.
Sources: Mortgage Bankers Association, *Mortgage News Daily; Business Week; EIR.*

TABLE 3

Projected Foreclosure Rates for Subprime Mortgage Loans Originated in 2006, for Top 15 MSAs*

Rank	MSA	Foreclosure Rate (%)
1	Merced, Calif.	25.0%
2	Bakersfield, Calif.	24.2
3	Vallejo-Fairfield, Calif.	23.8
4	Las Vegas-Paradise, Nev.	23.7
5 (tie)	Ocean City, N.J.	23.5
5 (tie)	Fresno, Calif.	23.5
7	Stockton, Calif.	23.4
8	Reno-Sparks, Nev.	23.2
9 (tie)	Santa Ana-Anaheim-Irvine, Calif.	22.8
9 (tie)	Washington D.C.-Northern Va.	22.8
11	Riverside-Ontario-San Bernardino, Calif.	22.6
12	Carson City, Nev.	22.5
13 (tie)	Atlantic City, N.J.	22.2
13 (tie)	Visalia-Porterville, Calif.	22.2
15 (tie)	Saginaw, Mich.	22.0
15 (tie)	Los Angeles-Long Beach, Calif.	22.0
15 (tie)	Nassau-Suffolk, N.Y.	22.0
Other Notable Projected High Foreclosure MSAs		
18	New York City	21.7
19	Tuscon, Arizona	21.6
21 (tie)	Rockford, Ill.	21.4
21 (tie)	Champagne-Urbana, Ill.	21.4
21 (tie)	San Diego-Carlsbad, Calif.	21.4
24 (tie)	Oakland-Fremont, Calif.	21.3
30	Lansing, Mich.	20.6

* A Metropolitan Statistical Area (MSA) is a Department of Commerce catergory, covering a city or cities, and the surrounding area.
Sources: Center for Responsible Lending; *EIR.*

Foreclosure

As these loans were extended, the volatility built into the mortgage bubble increased. The Center for Responsible Lending (CRL) issued a report in December 2006, which, working from the reality that housing prices were falling, not rising, projected the rate of foreclosure of subprime mortgages that were originated in that year (**Table 3**). The table shows that several of America's large cities are going to suffer an extraordinary 20% to 25% rate of foreclosure on subprime mortgages, including major cities such as New York, Los Angeles, San Diego, Tucson, and Washington, D.C. This will batter hundreds of thousands of households. With the subprime mortgage crisis intensifying, starting January 2007, the foreclosure rate could shoot considerably higher; this is one of the vectors that hit the subprime mortgages.

But consider the impossible situation the subprime mortgage lenders are in, and why there is no simple recovery. New Century Financial is essentially finished. However, it has debt obligations of $2.5 billion to Morgan Stanley, $1.4 billion to Credit Suisse, $600 million to Bank of America, $800 million

38 Mortgage Lenders Who Are Bankrupt/Ceased Operations

This is a partial list of the total number of subprime and/or mortgage lenders that have either gone bankrupt, or ceased most operations.

Maribella Mortgage—Couldn't handle the rising buybacks,and went bankrupt March 15, 2007.

FMF Capital LLC—Tried to sell-off operations, but couldn't. Went bankrupt March 9, 2007.

People's Choice Financial Corp.—According to reports, "officially" went under March 14, 2007.

New Century Financial Corp.—2nd largest U.S. subprime mortgage lender, forced to halt lending operations March 8, 2007. Is now in death-rattle.

Ameritrust Mortgage Company—North Carolina-based company's subprime unit shuttered March 2007.

Master Financial—Company website reports "will cease . . . accepting new applications for mortgage loans." March 2007.

Trojan Lending—California-based, went bankrupt March 2007.

Fremont General Corporation—4th largest U.S. subprime lender, stopped making subprime loans in early March 2007; hanging by a thread.

to IXIS Real Estate, and $100 million to Goldman Sachs, for a minimum total of $8.3 billion, though the real number could be double that.

How would New Century pay these debts? It has listed somewhere between $35 and $51 billion of subprime mortgage loans. If it offers them for sale, who will buy? Moreover, the act of selling them would dump more bad subprime mortgages on the market, depressing it further.

The box on bankrupt lenders shows that New Century is just one of 38 subprime mortgage or mortgage-lending institutions that have gone under since late 2006 (the companies listed are subprime lenders, unless otherwise noted).

Spreading Vectors

There is more to the story. Many of the mortgages are bundled together, in packages of $100 million or more, by Fannie Mae, Freddie Mac, and increasingly, the private investment banks, and sold as Mortgage Backed Securities (MBS) bonds, to investors, ranging from pension funds, hedge funds, and foreign central banks, like those of Japan, China, and Britain. These MBS bonds, although they are based on underlying mortgages, are totally separate and independent of the mortgages, carrying their own interest rates and risk. There are currently $6.3 trillion of these MBS outstanding. They are being destabilized by the shakeout of the subprime mortgages.

Adding the total of outstanding home mortgages—$10.2 trillion, and the $6.5 trillion of MBS, one arrives at a total size for U.S. housing-related paper of $16.7 trillion, one-third the size of the total U.S. credit market.

There is, as well, the vector to the derivatives market. There are credit default swaps, which are derivatives, issued against both subprime mortgages, and subprime mortgage MBS. The credit-default-swap derivatives issued against subprime instruments, are paying a record 20% premium cost, showing that the market has broken down and is illiquid. But these subprime-based credit-default swaps are part of the $34 trillion credit derivatives market, one of the most risky types of derivatives. They are building the potential to bring down the world's $600 trillion-plus world derivatives market,

Franklin Financial—Alt-A mortgage lender, ceased most operations Feb. 28, 2007.

Resmae—21st largest U.S. subprime lender; filed for bankruptcy Feb. 2007. Remains were bought by Credit Suisse.

ECC/Encore—24th largest U.S. subprime lender, substantially reduced operations Feb 2007; sold in fire sale to Bear Stearns.

Deep Green Financial Inc.—online home equity lender, went bankrupt Jan 2007.

Ownit Mortgage Solutions Inc.—17th largest U.S. subprime lender, filed Chaper 11 bankruptcy Dec. 28, 2006.

Harbourton Mortgage Investment Corporation (HMIC)—a mortgage banking operation, folded Dec. 20, 2006.

MLN—19th largest U.S. subprime lender, went bankrupt Dec. 12, 2006; shards of remains bought by Lehman Brothers.

Sebring Capital Partners—Carrollton, Texas-based; went bankrupt Dec. 4, 2006.

Ailing Lenders

Home lending institutions, though they have not shut down, are significantly downsizing and/or in manifest financial (or other) distress, and could close down.

Accredited Home Lenders—13th largest U.S. subprime lender exploring firesale-type options, which is often preparatory to closing, March 2007.

Ocwen Loan Servicing—mortgage loan servicer and lender, that is being sued by individuals and U.S. government, March 2007.

Option One—H&R Block owns Option One; Block now lists Option One in its own reports under "discontinued operations," March 2007.

Doral Financial Corp.—Doral must either refinance $625 million by July or face terminal cash crunch; March 2007.

Evergreen Investment/Carnation Bank—Evergreen which is in financial trouble, also being sued by investors and investigated by state and Federal authorities; January 2007.

Aegis Mortgage Corporation—Struggling company scaled back primary wholesale subprime operations, but company denies it has shut all such operations down; January 2007.

Coast Financial Holdings, Inc.—A "diversified" lender, announced anticipating problems with loans to 482 home borrowers, totalling $110 million; January 2007.

Residential Capital, Llc (ResCap)—ResCap is subsidiary of General Motors Acceptance Corp. (GMAC). General Motors had to infuse $1 billion into GMAC's ResCap subsidiary to cover $1 billion of ResCap losses due primarily to non-performing subprime loans; March 2007.

Fieldstone Mortgage Company—Closed 7 of 16 operations centers, and renegotiated covenants with lenders; January 2007.—*Richard Freeman.*

Sources: *The Mortgage Lender Implode-o-Meter; EIR;* wire service reports.

which would bankrupt the financial system.

And finally: one-half of the U.S. commercial banking system's assets of $11.73 trillion are invested in U.S. real estate, especially residential real estate.

Thus, in multiple ways, vectors from the subprime mortgage market drive into multiple points in fundamental ways into the world financial system. This goes to the heart of the world financial system. It is time that world leaders give LaRouche the backup for the steps he knows must be taken.

TABLE 4
The Top Ten U.S. Subprime Mortgage Lenders, 2006

Subprime Lenders	Market Share (%)	Loans ($ Billions)
1. Countrywide	8.0%	$38.5
2. New Century	7.0	33.9
3. Option One (H&R Block)	6.5	31.3
4. Fremont	6.2	29.8
5. Washington Mutual	6.0	28.8
6. First Franklin	5.8	28.3
7. RFC	5.4	25.9
8. Lehman Brothers	5.1	24.4
9. WMC (GE)	4.5	21.6
10. Ameriquest	4.4	21.4
Total	**58.8%**	**$283.9**

Timeline:

How the Now-Bursting Bubble Was Created

1982: Fracturing of Banking Regulation. The Garn-St Germain Depository Institutions Act (sponsored by Sen. Jake Garn (R-Utah), and Rep. Fernand St Germain (D-R.I.)) was signed into law on Oct. 15, 1982. The Act deregulated the banking system, and created the deregulated geometry to destroy the stable, traditional housing market. Vice President George H.W. Bush headed a task force which pushed through the legislation. Its key provisions were:

- The usury ceiling on what banks could charge on loans, set in most states at 10%, was repealed. During the early 1980s, the prime rate reached 21.5%;
- The lending limits for unsecured loans by banks to a single borrower were increased, thus increasing the amount of unsecured loans in the banking system;
- Commercial banks were de facto allowed (mostly because the Federal Reserve and other regulatory agencies turned a blind eye) to buy banks out of state, thus taking a step toward creation of super-banks, in violation of the Glass-Steagall Act of 1934;
- Commercial banks were permitted to create a category of loans and investments called "off-balance-sheet liabilities," which transformed into the $600-trillion-plus derivatives market.

1982: Until 1982, a homeowner took out a standard 30-year *fixed-interest-rate* mortgage, accompanied by a 20% downpayment. In that year, under Wall Street guidance, Congress passed the Alternative Mortgage Transaction Parity Act, which authorized for the first time, thrift institutions (savings banks, and savings and loan associations) to issue variable or adjustable-rate mortgages (ARMs), and to make "balloon payment" mortgages. Though commercial banks had had the power to issue ARMs—and usually didn't—now Wall Street pushed them to do so. Thus, during the late 1980s and 1990s, mortgage lenders increasingly issued ARMs, "balloon payments" mortgages, and other "alternative mortgages." This set the basis for the explosion of the dangerous "exotic" mortgages of the present, 21st-Century bubble.

1981-83: The circles of Lazard Frères investment bank took over Fannie Mae, and put a stop to the function for which FDR had established it in 1938. Fannie Mae bought mortgages from mortgage lending institutions, gave the institutions cash for the mortgages, and the mortgage lending institutions used the cash to make new mortgages. By repeating this cycle on a larger and larger scale, several times a year, with tens of thousands of lending institutions, Fannie pumped in walls of money, and, working with Fed chairman Alan Greenspan, amplified the housing bubble starting 1995.

Mid-1980s: Fannie pioneered a basically new instrument, called a Mortgage-Backed Security, which bundled together mortgages (from different lending institutions), and sold them to investors.* The MBS, though they are based upon mortgages, are completely independent instruments, with their own interest rate and their own increasing level of risk. The volume of MBS, issued by Fannie Mae, Freddie Mac, and increasingly by Wall Street banks, has risen from a trickle in the 1980s, to a level of few trillion dollars in the 1990s, to $6.3 trillion today.

*The MBS was created by Lewis Ranieri of Salomon Brothers in 1977, but it required an institution with Fannie Mae's muscle, to make the MBS widely accepted and traded.

1990s: With all of the above features going full bore, the subprime mortgage market was built up. On May 21, 2004, Federal Reserve Board Governor Edward M. Gramlach affirmed that "one of the key financial developments of the 1990s was the emergence and rapid growth of subprime mortgage lending. Because of regulatory changes [deregulation], the desire for increased profit, . . . and liberalization in some government mortgage support programs, lending institutions began extending credit to millions of borrowers. . . ." Subprime loans are loan-shark loans with oppressive fees, high penalties, and usurious interest rates, that target individuals and households with poor credit, usually from low-income households.

The share of subprime loans in total mortgage loans originated in a particular year, soared from 7% in 2001, to 11% in 2004, to 20% in 2006. However, the volume of subprime loans outstanding is even more stark: this jumped from $140 billion in 2000, to approximately $350-400 billion in 2003, to $1.2 trillion in 2006. The latter is 12.0% of all mortgages outstanding.

2000-01: After the "Information Technology" bubble crashed in March 2000, Fed chairman Greenspan decided to push the housing bubble into high gear to replace the IT bubble. Starting in 2001, Greenspan pushed through 13 cuts in the Federal Funds rate (the rate at which banks lend funds overnight); by August 2003, the Federal Funds rate stood at 1%, its lowest level in 40 years. By design, this pulled down the interest rate on mortgages. In this context, in addition to pushing subprime loans, the bankers absolutely destroyed traditional mortgage standards:

- Up until 1982, a home purchaser was required to make a downpayment of 20% of the home's sales price, so that the homeowner would start off with equity in the home. This downpayment was sliced to 15% by the start of the 1990s, approximately 10% by the end of the 1990s, and around 5% in the first decade of 2000. However, bankers found a way around that: "piggyback loans," two loans in which the first one is for the so-called mortgage, and the second is to enable the home buyer to pay the downpayment.
- Since 2000, bankers shifted to risky non-traditional/exotic loans. An example of that type is the "interest-only" loan. The loan is at an adjustable interest rate: for the first two to three years, the homebuyer pays a low "teaser" rate, of say 2-3%. During this initial period, the homebuyer pays no principal, but only interest at this lower rate. Then, after the initial period is over, the mortgage "resets," and the homebuyer must start paying principal, and also pay an adjustable rate of interest which is higher than the teaser rate. This leads to a shock, as the amount of monthly payment required often jumps by 50% or more.

Until 2001, nationally, fewer than 4% of buyers took out non-traditional or exotic loans. During the first half of 2006, 39% of all mortgage loan originations were of these risky exotic types.

- In 2000, only about 15% of subprime loans were undocumented, having no documented evidence of the income level, place of work, etc. By 2006, some 45-50% of subprime loan applications were undocumented. One study found that more than a third of the applicants' income levels were overstated by 50%. Also, a considerable portion of recent *non-subprime* loans were undocumented.

2006-07: The oustanding volume of unstable, risky, exotic loans is estimated by sources to be $1.5 trillion. The volume of subprime loans is estimated to be $1.2 trillion, by the Mortgage Bankers Association. Separating out the overlap, it is estimated that $2 trillion in mortgage loans are in very serious condition, with the potential of this spreading through other layers of the whole $10.2 trillion mortgage sector.

As for the banks, they have multiple layers of exposure. As of the third quarter of 2006, the U.S. banking system had $11.75 trillion in assets. Of that amount, 49%—or $5.7 trillion—was invested in real estate, primarily residential mortgages and MBS, according to the Federal Deposit Insurance Corporation. The mounting mortgage defaults and the collapse of the subprime mortgages and derivatives based on them, has the potential to rupture the banking system.

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View From 'Ground Zero'

Loudoun County Waits For Next Shoe To Drop

by L. Wolfe

Some foolish people in Loudoun County, Virginia, the Washington suburb that became the "poster child" of the Alan Greenspan housing bubble that is now going bust, read a recent uptick in home sales to proclaim that the area had weathered the crisis. However, more sober fellows understand that, as bad as things have been in Loudoun, where assessments of superinflated home values have fallen more than 10% in the last year, much worse is yet to come.

Sources in the local real estate industry dismiss the cheery words about a small increase in home sales in January and February, and point instead to the huge and growing inventory of unsold homes, now in the several scores of thousands. Even as the numbers of new housing permits have fallen off (**Figure 1**), homes in developers' pipelines keep pouring into this pool of unsold inventory. They are colliding with increasing numbers of older homes placed on the market by homeowners and speculators who fear that they bought their houses at too high a price, borrowed too much money, and might not get out "whole" if they wait to sell.

This deadly combination of inventory buildup continues to lead to a seemingly unstoppable rise in another telling statistic—the number of days a home stays on the market (**Figure 2**). That number is now climbing above 120 days, to almost 140 days. At the height of the white-hot "bubble market," homes were selling almost the moment they hit the market, with often several buyers bidding up the price above what was originally listed. That was a mere two years ago, but it seems like ancient times, now.

Foreclosures on the Rise

Also rising, along with the numbers of "For Sale" signs, are the number of foreclosures, mostly in the upper end of the market, among the so-called McMansions, million-dollar-plus homes on relatively small plots of land, which were once the most desired of purchases. The numbers of such foreclosures are still only a tiny segment of the market, kept down by factors that have given the rest of the market as well a ghostly afterlife.

Loudoun is the wealthiest county in the nation. As such, the majority of its homebuyers and homeowners had, and have, access to credit. As one realtor explained, that is the only reason that the market has not yet blown out. There are few subprime mortgages here, he said, although there were some "very creative" loans written up at the height of the bubble. Homes go into foreclosure because people have their credit cut off. That hasn't happened to a large extent here—*yet,* he continued. As long as most people are "right side up" on their mortgages (i.e., their property value exceeds their loans), they can continue to get credit and this takes pressure off possible bankruptcies and foreclosures, while keeping additional volumes of homes off the market, at least for the time being.

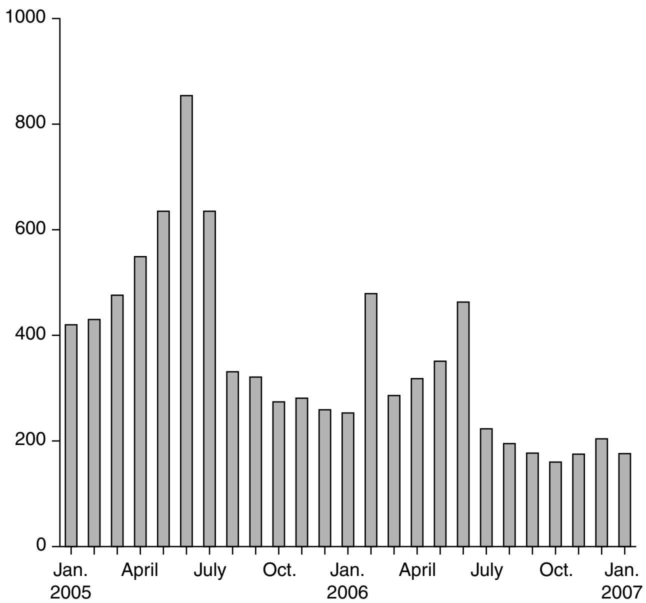
EIRNS/Stuart Lewis

A typical scene in the wealthiest county in the country.

The Developers Could Blow Up

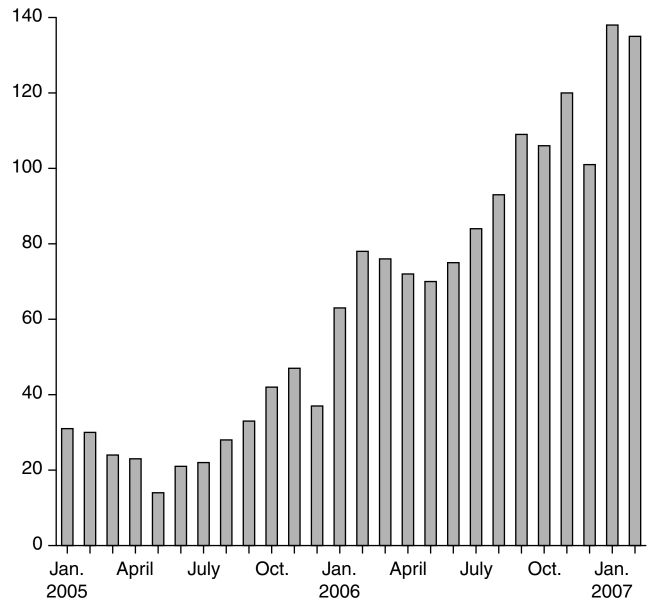
The Loudoun market, however, remains poised to blow

FIGURE 1
Residential Building Permits Issued Monthly, Loudoun County, Virginia



Source: Loudoun County Dept. of Economic Development.

FIGURE 2
Homes for Sale: Days on the Market, Loudoun County, Virginia



Source: Dulles Area Association of Realtors.

from another of its sectors: the developers of large residential and commercial tracts. These developers bought property at high market values, expecting huge returns in the near term, as they churned out homes, condos, and townhomes. With the market choking on inventory, these developers, such as Toll Brothers, NV Home, and Ryland are themselves choking on the debt that they must service. Loudoun was thought to be their gold-plated money-maker, which could support hard times in other locations; now, it can't even support itself.

Sooner or later, such developers will be forced either into bankruptcy or liquidation of inventory below their profit margins to make their debt payments. They have already seen their credit ratings downgraded, and in some cases, they are facing credit shutoffs.

"A homeowner might be able to wait it out for a year," said the realtor. "These developers can't wait. For the homeowner it is one property. For these guys, you're talking about hundreds or even thousands of homes. You do the math."

LaRouche Was Right on the Mark

Such a sell-off, in which properties will be bought up by wealthy people's monies being pulled out of hedge funds, will cause prices to plunge for everyone. In that way, the crisis in one portion of the local market rapidly becomes systemic throughout the entire market, with dire consequences for the national market.

Lyndon LaRouche has labelled Loudoun "Ground Zero" of the entire U.S. real estate bubble. For example, in a June 16, 2005 webcast, LaRouche warned:

"You have real estate bubbles, where you have shacks in the Washington, D.C. area, around it, where people have moved in from all over the world, to live in the D.C. area. . . .

"And this thing is about to come down. . . .

"Well, it's obvious to me, it's going to happen. I can see it in Northern Virginia. It's clear. We have Loudoun County, which is going to be a center of this catastrophe, because, it's been one of the areas that has been the most heavily built, with the least infrastructure. . . .

"This catastrophe *is going to happen.* It's not, 'if' it's going to happen; it's just a question of 'when'—and, 'when' is soon."

People familiar with the way Loudoun's once "gold-plated" loans have been bundled with subprime and other toilet-paper mortgages, realize how right LaRouche is. It is impossible to estimate how many mortgage bundles or how much value they represent, but the number is likely in the billions of dollars. Those mortgage bundles are held by many financial institutions; a collapse of value in Loudoun County could pull them all down.