



## **Mortgage Mess -- What We Did And How We Got Here**

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“Greed is good.” Those are the now famous words spoken by Gordon Gekko, one of the lead characters in Oliver Stone’s movie, “Wall Street.” We have all experienced both the good side of this motivational tool and the bad. Before we entered into the new century, the mortgage industry was embargoed from making loans to borrowers with a poor credit history and lack of supportable income because we were all operating under the guidelines established by the consortium of Fannie Mae, Freddie Mac and the FHA. They collectively made the loan underwriting guidelines that proved to be acceptable to the secondary market institutional investors, including the Wall Street community, pension funds, insurance companies, and other investors in Mortgage Backed Securities. The Mortgage Lending companies that were in the business of offering loans for borrowers, whether for new purchase loans or refinance transactions had to abide by those underwriting guidelines, unless they were capable of holding them in their own portfolios as an asset.

Savings and Loans across the country also looked at mortgage lending products as either salable in the secondary market, therefore subject to the same basic guidelines, or produced their own products for their own portfolio. The now reviled “Option Arm,” “Interest Only,” and “Stated Income” loan products were initially developed by some major S&L’s and Commercial Banks as portfolio loan products. They had been utilized by these institutions for more than 20 years and were available to clients who would qualify for them. The exception to these commonly used underwriting guidelines were those of the then-evolving Alternative-A paper lenders and “sub prime” lenders that became the 21st century dominant sources of mortgage capital to potential borrowers who had income documentation problems, credit issues and/or credit backgrounds that made them more challenging to the prime institutional lenders.

During this time, the amazing growth of companies like New Century, Ameriquest, Option One, and the other participants in that marketplace democratized these more conservative lending option programs to borrowers that would not have had them available five years earlier. Thus was started the slippery slope that enriched many people in the years from 1997 through 2005, which ultimately caused most of these participant companies to close their doors by the end of 2007.

Greed has many handmaidens. In this case, you would have to include the borrowers who wanted to speculate that they could manage more debt than they could and buy a bigger more expensive home. There were mortgage brokers who didn’t live up to their professional responsibilities and mortgage lending companies that ignored many of the warnings that were there to be seen.

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Rating agencies like S&P, Moody's, and Fitch hid behind financial structures that were truly halls of mirrors created by financial intermediaries that also paid their fees for the ratings they issued. There were also the institutional consolidators like the major Wall Street companies and the institutional investors who bought these products after they had been converted into Mortgage Backed Derivative financial instruments and given Investment Grade ratings.

As in most major screw ups, including financial upsets, every player had a role in its success – and failure. “A rolling loan gathers no loss,” was the operative idea and ultimately, as these loans passed through the system, no one felt seem to take responsibility for their viability – as long as they made their monies. As a consequence, no one is exempt from the recognition that they helped cause the current industry challenges.

“Back to the Future” was the title of a series of movies in the late 1980s and early 1990s that is also the vision of our collective financial near future in Mortgage Lending. By near future, I mean the next three to five years. We have looked back to the time when we made loans that required loan underwriting standards would be universally understood and applied. Down payments for home purchases were expected in most situations and borrowers knew that their credit backgrounds would be reviewed and if found to be inadequate, they would and could be denied the loan.

That seems to be the near future because fear and despair never last too long. Someone, somewhere, will persuade themselves and others that there is a lot of money to be made by being a little more aggressive, more “forward thinking” and we will start again to look at the short-term gains to be achieved, irrespective of the risk to be overcome. At that time, many of the lending institutions will undoubtedly convince themselves that they are smarter this time around, know more, and can manage the slight increase in default risk in order to achieve a higher bottom line on their financial statements.

And so it will start again. Just wait and see.

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