

# White House to reveal sub-prime rescue for struggling US homeowners

## Deal with lenders will freeze interest rates on 'teaser' loans but critics say the crisis now extends to other borrowers

---

By: Andrew Clark

THURSDAY, DECEMBER 6 2007

**The Guardian** - President Bush will wade into the sub-prime mortgage crisis today with a rescue package freezing interest rates on certain high-risk home loans for up to five years.

After protracted negotiations with America's biggest lenders, the White House is set to announce a package providing relief for a limited number of cash-strapped homeowners who are on the brink of foreclosure.

The freeze will apply to mortgages with short-term "teaser" interest rates which are due to jump to much higher rates between 2008 and 2010.

In a deal negotiated by treasury secretary Henry Paulson there will also be help to speed up refinancing deals for people struggling with repayments.

The move is a rare intervention from an administration which prides itself on its laissez-faire economic approach. It has been cautiously welcomed by community groups, although critics say the crisis has gone far beyond the sub-prime sector.

Speaking at the hi-tech stockmarket Nasdaq yesterday, the Democratic presidential frontrunner Hillary Clinton admonished financiers for the crisis, saying: "Wall Street not only enabled, but often encouraged, reckless lending." She said bank bosses were hardly paying the price: "People have lost their jobs in this city but they've left with millions of dollars - they're not being held responsible."

Experts believe that as many as 2m homes are at risk of repossession as a slump in the property market makes it difficult for struggling owners to refinance overly-aggressive mortgages.

A government investigation into the financial industry's role in the crisis has widened. It emerged yesterday that senior bankers at many of Wall Street's leading firms have been questioned under subpoenas issued by New York's attorney general, Andrew Cuomo.

Deutsche Bank, Merrill Lynch and Bear Stearns are among those which have been called on to explain their conduct in buying high-risk home loans, repackaging them as credit instruments and selling them to investors.

A source at one bank said: "They went out to all the big Wall Street shops - at least all the ones that have a mortgage desk, which is pretty much all of them.

"The scope was pretty broad - it was pretty much looking at the whole mortgage industry from start to finish."

Cuomo wants to know how thoroughly the banks looked at the quality of mortgages before parcelling them up. The move is a significant extension of his inquiry, which initially focused on alleged collusion between mortgage providers and property appraisers to artificially inflate house values.

Last month, Cuomo attacked the mortgage industry for conspiring to "rip off homeowners and investors alike".

In spite of ongoing credit woes, it was a day of relief for Wall Street, with better than expected economic figures pushing stock prices sharply higher. The Dow Jones Industrial Average jumped 196 points to 13,444.

The labour department reported that productivity rose by 6.3% over the summer - the biggest jump since 2003 - prompting employment costs to drop by an average of 2%. The rise in efficiency is likely to help companies withstand a widely expected economic downturn.

In addition, a report from ADP Employment Services said 189,000 new jobs were created in November - three times the number anticipated by analysts.

In a sign of the risks of the credit crunch, officials in Florida spent the day scrambling to rescue an investment fund for local councils following a run of withdrawals prompted by concern about its exposure to mortgage-related securities.

Panic erupted when investors learned that about \$2bn of the fund's money was in investments sharply downgraded by the sub-prime crisis. Florida's state government froze withdrawals after almost half of its money was taken out, cutting the fund's value from \$27bn to \$14bn.

The freeze prompted some towns and cities to complain that they lacked the money to pay teachers and other municipal workers. "We're between a rock and a hard spot," said Bill Montford, head of the Florida Association of School Superintendents.

The head of the board administering the fund, Coleman Stipanovich, resigned. Officials called in the investment firm Blackrock to advise on restructuring, prompting hopes that limited withdrawals could be allowed today.

Unease spread to other states, which were quick to defend their public investment pools. Montana has 23% of its funds tied up in commercial paper - which has been at

the centre of the credit crunch. But the state insisted that its position was "workable".

One of the Wall Street firms worst hit by the sub-prime mortgage crisis, Bear Stearns, was served with a fresh round of investor lawsuits. Two of its hedge funds collapsed in July, wiping out \$1.6bn of investments.

**The plaintiffs' lawyer, Steve Caruso, said: "Officials at Bear Stearns engaged in a concerted effort to conceal the true state of affairs at both of these hedge funds for an extended period before they imploded."**

Merrill Lynch joined Goldman Sachs this week in predicting that a recession is likely to grip the US next year. The bank predicted that the Federal Reserve will cut interest rates as low as 2% in an attempt to kick-start the economy.

### **FAQ: Bad debts**

What are sub-prime mortgages?

Home loans sold to borrowers with poor credit records who are now encountering difficulties with payments.

Why are sub-prime mortgages causing problems in the financial markets?

Many US mortgages have been packaged into pools of debt and turned into complex investment products. As borrowers default on these loans, the banks' investments fall in value, causing a chain reaction across markets.

What is a structured investment vehicle (SIV)?

An investment company that exists outside a bank's balance sheet. It generally invests in long-term assets, but funds itself through short-term money markets. Many SIVs have invested in the debt pools created from sub-prime mortgages.