



Playing the Subprime Mortgage Game

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STAMFORD - Before the housing bubble burst last year, the mortgage market resembled a kids game, according to one University of Connecticut-Stamford professor.

"It was like musical chairs," said Walter Dolde, a UConn finance professor who previously worked on Wall Street with former Federal Reserve chairman Alan Greenspan and at Lehman Brothers and Citibank Investment Bank.

"As long as the music is playing it doesn't matter that there's not enough chairs," Dolde said. "When housing prices were going up everything was fine."

But the number of subprime mortgages to borrowers who didn't have the financial backing to own a home continued to skyrocket, and some institutional investors were involved in transactions with mortgage-backed securities that they really didn't understand, Dolde said.

As part of UConn-Stamford's Faculty Colloquium Series, Dolde painted a picture of the winners and losers of the subprime debacle for an audience of about 12 people.

The Faculty Colloquium series has been established by UConn to showcase its Stamford faculty, said Michael Ego, associate vice provost.

"This is topical, and he (Dolde) is an academic scholar," Ego said. "I want to showcase the excellence of our faculty. There is this perception that out faculty here in Stamford are not as strong as they are in Storrs."

One of the lessons Dolde said should be learned from the subprime fallout is, "You can't let unsophisticated people take out loans on an asset whose value may fall."

Many borrowers were only able to afford the first two years of their subprime loan before interest rates spiked. During a hot housing market, homeowners would refinance every two years to keep their heads above water, Dolde said.

But when housing prices started to drop, the rules for many homeowners changed. Without the ability to refinance, many borrowers started suffering huge losses of equity while trying to make mortgage payments, Dolde said.

More than half of all subprime borrowers have negative equity, and that number could soon approach 65 percent to 75 percent, he said.

Some borrowers were the victims of predatory lending, where they were steered into signing a loan arrangement of which they had no understanding. But in other cases, the loan originators did not behave fraudulently, Dolde said.

Many investors were burned because they did not diversify their portfolios and instead craved the fast money they were making from mortgage-backed securities, Dolde said.

"Diversity is the first rule of investing," he said. "The maximum hit on the portfolios of adequately diversified investors will not exceed 1 percent. But some inadequately diversified investors will lose much higher percentages."

Dolde lauded David Viniar, chief financial officer of Goldman Sachs as a "hero" because he was one of the first to recognize the risk of these securities in the fall of 2006.

But, Dolde agreed with Greenspan's assessment that the benefits of subprime mortgages outweighed the risks.

"Millions of households enjoy the benefits of ownership for the first time," Dolde said, adding that the market went sour because it was "the dose was toxic, not the substance."

Housing and stock prices are about where they were two years ago.

"You were not as wealthy as you felt then, and you are not as poor as you feel now," Dolde said.

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