

## Story of a sub-prime mortgage

By Sanchia Berg

Today programme

**The story starts in Westminster, Colorado, a pleasant suburb of Denver. That is where Roger Rodriguez, a truck driver, was living in 2004 when he decided to take out a new mortgage. He was then 58.**

He had bought his family home 20 years before - an apartment in a small development called "Prospector's Point". He lived there with his wife and two young grandchildren.

Roger Rodriguez had already taken some equity out of his property, so he had a mortgage of \$70,000, and he decided to extend his borrowing to consolidate some debt. He had credit cards he wanted to pay off.

While his credit rating was not perfect, he had been working for the same company for 17 years, and valuers told him his home was worth at least \$120,000.

He went to a local broker in Denver and was offered a mortgage at a starter rate of 6%. The rate would rise sharply after two years. As Mr Rodriguez was earning \$4,000 per month before tax, he was not especially worried. Plus, he planned to refinance before that increase kicked in.

A local broker arranged the loan through the national CIT group, who then sold Mr Rodriguez's loan to RBS Greenwich Capital. Part of the Royal Bank of Scotland, it still describes itself on its website as specialising in mortgage backed securities.

### Risky bonds

At the time, late 2004, this was a highly competitive market, and RBS was trying to become a leading player, according to Carrick Mollenkamp, of the Wall Street Journal, who tracked Mr Rodriguez' mortgage back to Greenwich and on to mutual funds.

"They were trying to buy up as many of these loans as possible...they would put these loans on a hypothetical shelf and when they had enough they'd turn them into securities," Mr Mollenkamp says.

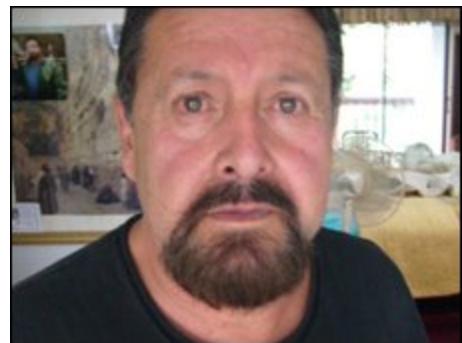
In February 2005 Mr Rodriguez' loan was packaged up with 4853 other mortgages into a trust called Soundview 2005-1. The cash flow from all the loans was turned into notes - bonds - of differing quality, paying out different rates.

The top tranche would get the first interest payments and were more reliable.

Notes lower down the pile were riskier, but with potentially higher yields. They sold \$778M worth of bonds in just five days.

One customer who bought \$8m of the riskier bonds was James Kelsoe, a fund manager in Tennessee. He worked for a brokerage firm called Morgan Keegan.

His funds performed exceptionally well, they had risen on



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Roger Rodriguez

average 14% a year over the previous five years, but they were also marketed as safe.

### Changing market

It was security which appealed to Katherine and Lester Poer, a retired couple in a small town on the Alabama coast. In 2005, their children had left home, and the couple had literally moved their house to raise money - that is, shifted their wooden home onto a small plot and sold the original larger piece of land.

The Poers wanted to use the capital to help their pensions, as they had few other savings. They wanted to have the money available too, in case they needed it for care. Mr Poer is now 81. "This was money we couldn't afford to lose," he said.

The Poers put \$250,000 into one of Mr Kelsoe's funds. Mr Poer told me that their accountant recommended Morgan Keegan - as he said he did not know anything about investments.

That was the path of Soundview 2005-1 in the real world. But it very likely gave rise to derivatives too, in the less tangible cyber world of high finance.

However, as derivatives are not openly traded it is impossible to know for sure. The most likely type would have been a credit default swap - in essence a kind of insurance policy.

### TRAIL OF A MORTGAGE

**2004** Roger Rodriguez takes out mortgage for \$88,000

Rodriguez loan sold by CIT to RBS Greenwich Capital, Connecticut

Rodriguez loan packaged into a trust named Soundview 2005-1

**Feb 2005** RBSGTC sell bonds worth \$778m from Soundview

James Kelsoe of Morgan Keegan buys \$8m of riskier bonds

The Poers invest savings worth \$250,000 into a fund run by Kelsoe

**Feb 2006** Mr Rodriguez loses his job and falls behind on mortgage payments

At first, these were taken out by the buyers of bonds like Soundview 2005-1 - to protect themselves in case of default. But then the market changed.

**June 2007** Defaults affect 3.44% of the loan pool

"We had this peculiar situation develop in 2006 where there was such amazing voracious appetite for subprime mortgage debt that there weren't actually enough subprime mortgages out in the market to satisfy it. So people started to turn to derivatives instead," says Gillian Tett, Capital Markets Editor of the Financial Times.

**Autumn 2007** Mr Rodriguez loses his home

**2008** Poer savings now worth only \$37,000

"They used the derivatives to make bets on the performance of the sector," she added.

But the bonds and probable derivatives depended on people like Roger Rodriguez paying his mortgage. In February 2006 he was involved in an accident at work. After he had parked one of his trucks, the tractor rolled away and caused \$2,000 of damage.

He was sacked, and found it hard to find other employment - after all, he was over 60.

He struggled to meet the mortgage - and then, in November 2006, the payment increased.

Though he was working casual night shifts at the post office, he was only earning \$11 per hour. He decided to file for bankruptcy, and let his home be taken.

"It was devastating," he told me. "It hit me very hard. I just didn't plan on something like that happening. I guess in my mind I never thought I would lose that job."

### Lost savings

He was not the only borrower in the Soundview 2005-1 group to default. By summer 2007, defaults were affecting 3.44% of the loans, and the value of the bonds fell.

Mr Kelsoe's funds began to lose value too. About 15 months ago, Lester Poer, in Alabama, noticed that his account had lost about \$15,000 in a month.

He raised concerns with Morgan Keegan - and was told to hang on, the fund would pick up again. But it never did. When earlier this year he sold the account, he received just \$37,000.

Now the Poers are suing Morgan Keegan, over the way the funds were sold to them. Their lawyer is Peter Mougey of the Florida firm Levin Papantonio Thomas Mitchell Echsner & Proctor.

He said they are not unique - he has other elderly clients who needed a safe investment and ended up losing their savings in Morgan Keegan. Many hundreds of former investors have filed suits.



Rising interest rates hit many US homeowners hard

What of the effects in the derivative world? That is impossible to know because, as Gillian Tett says, "It's only when banks write off their derivative losses we know they had them in the first place."

It was of course fear of such toxic debt which caused banks to stop lending to each other earlier this month and brought about the financial crisis.

