

BROKEN HOMES

What the subprime crisis tells us about the importance of community financial institutions.



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ACROSS THE U.S., PEOPLE ARE LOSING THEIR HOMES. IN JUST the month of July, more than a quarter-million American households received a foreclosure-related filing, telling them to pay up or be put out on the street. ¶ Numbers like these fail to convey the oceans of human heartache they represent. The so-called “subprime crisis” is really a story about Americans’ homes and the broken system within which we buy and try to hold on to them. ¶ There’s plenty of blame to go around. Some certainly

belongs to speculators planning to “flip” houses in a rising market. These buyers are partly to blame for the run-up in prices. Some belongs to homebuyers who took advantage of loans without background checks, which allowed them to lie about their income and assets. Other borrowers didn’t think about the possibility of rising payments, or didn’t fully understand the terms of their loans.

Much more blame goes to dishonest mortgage salesmen and their company CEOs. But the root causes of this crisis lie in yet another corruption of capitalism, in which the only value seems to be that of the quick buck.

Not many years ago, America’s home-finance system looked much like the one portrayed in the 1946 film classic *It’s a Wonderful Life*. Workers and middle-class people put their savings (yes, back then Americans actually saved) into local banks closely supervised by regulators. When community members were ready to buy houses, they’d go to the same places for their mortgages.

The relationship between the banks and their customers was long term, and all parties were invested in the homes and the communities. These banks’ survival depended on the care with which they made loans, and on their borrowers’ ability to pay. *It’s a Wonderful Life* allowed a bank president to look into the future: into a world with no



carrying bank, into a town’s demise. It showed how those local financial institutions were the backbones of their communities, and suggested the social breakdown that would occur if they were no longer around.

Six decades later, home finance works very differently. As the banking sector consolidated, local banking institutions disappeared. Deposit accounts and mortgage loans became commodities, sold on the basis of interest rates rather than service quality,

local presence or long-term relationship. Quasi-governmental home-finance institutions like Fannie Mae and Freddie Mac, designed to make home ownership easier for middle-class Americans, turned many banks into little more than loan-origination companies. The mortgages they issued were packaged and sold to other investors. Lenders stopped worrying about whether loans would get repaid, focused as they were on their initial sales commissions.

Meanwhile, the feds eliminated crucial government oversight, and the Federal Reserve embarked on a policy of easy credit for all. Investment banks used their massive brainpower to structure esoteric ways to package and sell mortgage loans. And millions of people saw the easy money, heard the sales pitches, ignored the fine print, believed the housing market would keep rising forever and signed on the dotted line.

The salesperson focuses on his commission, the CEO or investment banker on her bonus. The politician focuses on his ideology (or on winning elections). The business community pushes for less oversight, less regulation and less responsibility as it maximizes profits.

There is, however, another way, and it can be seen in communities across the U.S. (Under the heading of microfinance, it’s also an important trend in other parts of the world.) Community banks, credit unions and other community development financial institutions (CDFIs) are lending money the old-fashioned way—in a context of long-term relationships between both borrowers and their communities. In my next column, I’ll take a look at how CDFIs are addressing the foreclosure crisis, and showing us a model for more sustainable financial services.

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