GlobalResearch
Center for Research on Globalization

Looting Main Street: How the Nation's Biggest Banks are ripping off American Cities

By Matt Taibbi

Global Research, April 12, 2010
Rolling Stone 31 March 2010

Region: USA
Theme: Global Economy

How the nation's biggest banks are ripping off American cities with the same predatory deals that brought down Greece

If you want to know what life in the Third World is like, just ask Lisa Pack, an administrative assistant who works in the roads and transportation department in Jefferson County, Alabama. Pack got rudely introduced to life in post-crisis America last August, when word came down that she and 1,000 of her fellow public employees would have to take a little unpaid vacation for a while. The county, it turned out, was more than $5 billion in debt — meaning that courthouses, jails and sheriff's precincts had to be closed so that Wall Street banks could be paid.

As public services in and around Birmingham were stripped to the bone, Pack struggled to support her family on a weekly unemployment check of $260. Nearly a fourth of that went to pay for her health insurance, which the county no longer covered. She also fielded calls from laid-off co-workers who had it even tougher. "I'd be on the phone sometimes until two in the morning," she says. "I had to talk more than one person out of suicide. For some of the men supporting families, it was so hard — foreclosure, bankruptcy. I'd go to bed at night, and I'd be in tears."

Homes stood empty, businesses were boarded up, and parts of already-blighted Birmingham began to take on the feel of a ghost town. There were also a few bills that were unique to the area — like the $64 sewer bill that Pack and her family paid each month. "Yeah, it went up about 400 percent just over the past few years," she says.

The sewer bill, in fact, is what cost Pack and her co-workers their jobs. In 1996, the average monthly sewer bill for a family of four in Birmingham was only $14.71 — but that was before the county decided to build an elaborate new sewer system with the help of out-of-state financial wizards with names like Bear Stearns, Lehman Brothers, Goldman Sachs and JP Morgan Chase. The result was a monstrous pile of borrowed money that the county used to build, in essence, the world's grandest toilet — "the Taj Mahal of sewer-treatment plants" is how one county worker put it. What happened here in Jefferson County would turn out to be the perfect metaphor for the peculiar alchemy of modern oligarchical capitalism: A mob of corrupt local officials and morally absent financiers got together to build a giant device that converted human shit into billions of dollars of profit for Wall Street — and misery for people like Lisa Pack.

And once the giant shit machine was built and the note on all that fancy construction started to come due, Wall Street came back to the local politicians and doubled down on the scam.

They showed up in droves to help the poor, broke citizens of Jefferson County cut their toilet finance charges using a blizzard of incomprehensible swaps and refinance schemes — schemes that only served to postpone the repayment date a year or two while sinking the county deeper into debt. In the end, every time Jefferson County so much as breathed near one of the banks, it got charged millions in fees. There was so much money to be made bilking these dizzy Southerners that banks like JP Morgan spent millions paying middlemen who bribed — yes, that's right, bribed, criminally *bribed* — the county commissioners and their buddies just to keep their business. Hell, the money was so good, JP Morgan at one point even paid Goldman Sachs $3 million just to back the fuck off, so they could have the rubes of Jefferson County to fleece all for themselves.

Birmingham became the poster child for a new kind of giant-scale financial fraud, one that would threaten the financial stability not only of cities and counties all across America, but even those of entire countries like Greece. While for many Americans the financial crisis remains an abstraction, a confusing mess of complex transactions that took place on a cloud high above Manhattan sometime in the mid-2000s, in Jefferson County you can actually see the rank criminality of the crisis economy with your own eyes; the monster sticks his head all the way out of the water. Here you can see a trail that leads directly from a billion-dollar predatory swap deal cooked up at the highest levels of America's biggest banks, across a vast fruited plain of bribes and felonies — "the price of doing business," as one JP Morgan banker says on tape — all the way down to Lisa Pack's sewer bill and the mass layoffs in Birmingham.

Once you follow that trail and understand what took place in Jefferson County, there's really no room left for illusions. We live in a gangster state, and our days of laughing at other countries are over. It's our turn to get laughed at. In Birmingham, lots of people have gone to jail for the crime: More than 20 local officials and businessmen have been convicted of corruption in federal court. Last October, right around the time that Lisa Pack went back to work at reduced hours, Birmingham's mayor was convicted of fraud and money-laundering for taking bribes funneled to him by Wall Street bankers — everything from Rolex watches to Ferragamo suits to cash. But those who greenlighted the bribes and profited most from the scam remain largely untouched. "It never gets back to JP Morgan," says Pack.

If you want to get all Glenn Beck about it, you could lay the blame for this entire mess at the feet of weepy, tree-hugging environmentalists. It all started with the Cahaba River, the longest free-flowing river in the state of Alabama. The tributary, which winds its way through Birmingham before turning diagonally to empty out near Selma, is home to more types of fish per mile than any other river in America and shelters 64 rare and imperiled species of plants and animals. It's also the source of one of the worst municipal financial disasters in American history.

Back in the early 1990s, the county's sewer system was so antiquated that it was leaking raw sewage directly into the Cahaba, which also supplies the area with its drinking water. Joined by well — intentioned citizens from the Cahaba River Society, the EPA sued the county to force it to comply with the Clean Water Act. In 1996, county commissioners signed a now-infamous consent decree agreeing not just to fix the leaky pipes but to eliminate *all* sewer overflows — a near-impossible standard that required the county to build the most elaborate, ecofriendly, expensive sewer system in the history of the universe. It was like ordering a small town in Florida that gets a snowstorm once every five years to build a billion-dollar fleet of snowplows.

The original cost estimates for the new sewer system were as low as $250 million. But in a wondrous demonstration of the possibilities of small-town graft and contract-padding, the price tag quickly swelled to more than $3 billion. County commissioners were literally pocketing wads of cash from builders and engineers and other contractors eager to get in on the project, while the county was forced to borrow obscene sums to pay for the rapidly spiraling costs. Jefferson County, in effect, became one giant, TV-stealing, unemployed drug addict who borrowed a million dollars to buy the mother of all McMansions — and just as it did during the housing bubble, Wall Street made a business of keeping the crook in his house. As one county commissioner put it, “We’re like a guy making $50,000 a year with a million-dollar mortgage.”

To reassure lenders that the county would pay its mortgage, commissioners gave the finance director — an unelected official appointed by the president of the commission — the power to automatically raise sewer rates to meet payments on the debt. The move brought in billions in financing, but it also painted commissioners into a corner. If costs continued to rise — and with practically every contractor in Alabama sticking his fingers on the scale, they were rising fast — officials would be faced with automatic rate increases that would piss off their voters. (By 2003, annual interest on the sewer deal had reached $90 million.) So the commission reached out to Wall Street, looking for creative financing tools that would allow it to reduce the county’s staggering debt payments.

Wall Street was happy to help. First, it employed the same trick it used to fuel the housing crisis: It switched the county from a fixed rate on the bonds it had issued to finance the sewer deal to an adjustable rate. The refinancing meant lower interest payments for a couple of years — followed by the risk of even larger payments down the road. The move enabled county commissioners to postpone the problem for an election season or two, kicking it to a group of future commissioners who would inevitably have to pay the real freight.

But then Wall Street got really creative. Having switched the county to a variable interest rate, it offered commissioners a crazy deal: For an extra fee, the banks said, we’ll allow you to keep paying a fixed rate on your debt to us. In return, we’ll give you a variable amount each month that you can use to pay off all that variable-rate interest you owe to bondholders.

In financial terms, this is known as a *synthetic rate swap* — the spidery creature you might have read about playing a role in bringing down places like Greece and Milan. On paper, it made sense: The county got the stability of a fixed rate, while paying Wall Street to assume the risk of the variable rates on its bonds. That’s the *synthetic* part. The trouble lies in the rate swap. The deal only works if the two variable rates — the one you get from the bank, and the one you owe to bondholders — actually match. It’s like gambling on the weather. If your bondholders are expecting you to pay an interest rate based on the average temperature in Alabama, you don’t do a rate swap with a bank that gives you back a rate pegged to the temperature in Nome, Alaska.

Not unless you’re a fucking moron. Or your banker is JP Morgan.

In a small office in a federal building in downtown Birmingham, just blocks from where civil rights demonstrators shut down the city in 1963, Assistant U.S. Attorney George Martin points out the window. He’s pointing in the direction of the Tutwiler Hotel, once home to one of the grandest ballrooms in the South but now part of the Hampton Inn chain.

"It was right around the corner here, at the hotel," Martin says. "That's where they met — that's where this all started."

They means Charles LeCroy and Bill Blount, the two principals in what would become the most important of all the corruption cases in Jefferson County. LeCroy was a banker for JP Morgan, serving as managing director of the bank's southeast regional office. Blount was an Alabama wheeler-dealer with close friends on the county commission. For years, when Wall Street banks wanted to do business with municipalities, whether for bond issues or rate swaps, it was standard practice to reach out to a local sleazeball like Blount and pay him a shitload of money to help seal the deal. "Banks would pay some local consultant, and the consultant would then funnel money to the politician making the decision," says Christopher Taylor, the former head of the board that regulates municipal borrowing. Back in the 1990s, Taylor pushed through a ban on such backdoor bribery. He also passed a ban on bankers contributing directly to politicians they do business with — a move that sparked a lawsuit by one aggrieved sleazeball, who argued that halting such legalized graft violated his First Amendment rights. The name of that pissed-off banker? "It was the one and only Bill Blount," Taylor says with a laugh.

Blount is a stocky, stubby-fingered Southerner with glasses and a pale, pinched face — if Norman Rockwell had ever done a painting titled "Small-Town Accountant Taking Enormous Dump," it would look just like Blount. LeCroy, his sugar daddy at JP Morgan, is a tall, bloodless, crisply dressed corporate operator with a shiny bald head and silver side patches — a cross between Skeletor and Michael Stipe.

The scheme they operated went something like this: LeCroy paid Blount millions of dollars, and Blount turned around and used the money to buy lavish gifts for his close friend Larry Langford, the now-convicted Birmingham mayor who at the time had just been elected president of the county commission. (At one point Blount took Langford on a shopping spree in New York, putting $3,290 worth of clothes from Zegna on his credit card.) Langford then signed off on one after another of the deadly swap deals being pushed by LeCroy. Every time the county refinanced its sewer debt, JP Morgan made millions of dollars in fees. Even more lucrative, each of the swap contracts contained clauses that mandated all sorts of penalties and payments in the event that something went wrong with the deal. In the mortgage business, this process is known as *churning*: You keep coming back over and over to refinance, and they keep "churning" you for more and more fees. "The transactions were complex, but the scheme was simple," said Robert Khuzami, director of enforcement for the SEC. "Senior JP Morgan bankers made unlawful payments to win business and earn fees."

Given the shitload of money to be made on the refinancing deals, JP Morgan was prepared to pay whatever it took to buy off officials in Jefferson County. In 2002, during a conversation recorded in Nixonian fashion by JP Morgan itself, LeCroy bragged that he had agreed to funnel payoff money to a pair of local companies to secure the votes of two county commissioners. "Look," the commissioners told him, "if we support the synthetic refunding, you guys have to take care of our two firms." LeCroy didn't blink. "Whatever you want," he told them. "If that's what you need, that's what you get. Just tell us how much."

Just tell us how much. That sums up the approach that JP Morgan took a few months later, when Langford announced that his good buddy Bill Blount would henceforth be involved with every financing transaction for Jefferson County. From JP Morgan's point of view, the decision to pay off Blount was a no-brainer. But the bank had one small problem: Goldman Sachs had already crawled up Blount's trouser leg, and the broker was advising Langford to pick *them* as Jefferson County's investment bank.

The solution they came up with was an extraordinary one: JP Morgan cut a separate deal with Goldman, paying the bank $3 million to fuck off, with Blount taking a $300,000 cut of the side deal. Suddenly Goldman was out and JP Morgan was sitting in Langford's lap. In another conversation caught on tape, LeCroy joked that the deal was his "philanthropic work," since the payoff amounted to a "charitable donation to Goldman Sachs" in return for "taking no risk."

That such a blatant violation of anti-trust laws took place and neither JP Morgan nor Goldman have been prosecuted for it is yet another mystery of the current financial crisis. "This is an open-and-shut case of anti-competitive behavior," says Taylor, the former regulator.

With Goldman out of the way, JP Morgan won the right to do a $1.1 billion bond offering — switching Jefferson County out of fixed-rate debt into variable-rate debt — and also did a corresponding $1.1 billion deal for a synthetic rate swap. The very same day the transaction was concluded, in May 2003, LeCroy had dinner with Langford and struck a deal to do yet *another* bond-and-swap transaction of roughly the same size. This time, the terms of the payoff were spelled out more explicitly. In a hilarious phone call between LeCroy and Douglas MacFaddin, another JP Morgan official, the two bankers groaned aloud about how much it was going to cost to satisfy Blount:

LeCroy: I said, "Commissioner Langford, I'll do that because that's your suggestion, but you gotta help us keep him under control. Because when you give that guy a hand, he takes your arm." You know?

MacFaddin: [*Laughing*] Yeah, you end up in the wood-chipper.

All told, JP Morgan ended up paying Blount nearly $3 million for "performing no known services," in the words of the SEC. In at least one of the deals, Blount made upward of 15 percent of JP Morgan's entire fee. When I ask Taylor what a legitimate consultant might earn in such a circumstance, he laughs. "What's a 'legitimate consultant' in a case like this? He made this money for doing jack shit."

As the tapes of LeCroy's calls show, even officials at JP Morgan were incredulous at the money being funneled to Blount. "How does he get 15 percent?" one associate at the bank asks LeCroy. "For doing what? For not messing with us?"

"Not messing with us," LeCroy agrees. "It's a lot of money, but in the end, it's worth it on a billion-dollar deal."

That's putting it mildly: The deals wound up being the largest swap agreements in JP Morgan's history. Making matters worse, the payoffs didn't even wind up costing the bank a dime. As the SEC explained in a statement on the scam, JP Morgan "passed on the cost of the unlawful payments by charging the county higher interest rates on the swap transactions." In other words, not only did the bank bribe local politicians to take the sucky deal, they got local taxpayers to pay for the bribes. And because Jefferson County had no idea what kind of deal it was getting on the swaps, JP Morgan could basically charge whatever it wanted. According to an analysis of the swap deals commissioned by the county in 2007, taxpayers had been overcharged at least $93 million on the transactions.

JP Morgan was far from alone in the scam: Virtually everyone doing business in Jefferson County was on the take. Four of the nation's top investment banks, the very cream of American finance, were involved in one way or another with payoffs to Blount in their scramble to do business with the county. In addition to JP Morgan and Goldman Sachs, Bear Stearns paid Langford's bagman $2.4 million, while Lehman Brothers got off cheap with a $35,000 "arranger's fee." At least a dozen of the county's contractors were also cashing in, along with many of the county commissioners. "If you go into the county courthouse," says Michael Morrison, a planner who works for the county, "there's a gallery of past commissioners on the wall. On the top row, every single one of 'em but two has been investigated, indicted or convicted. It's a joke."

The crazy thing is that such arrangements — where some local scoundrel gets a massive fee for doing nothing but greasing the wheels with elected officials — have been taking place all over the country. In Illinois, during the Upper Volta-esque era of Rod Blagojevich, a Republican political consultant named Robert Kjellander got 10 percent of the entire fee Bear Stearns earned doing a bond sale for the state pension fund. At the start of Obama's term, Bill Richardson's Cabinet appointment was derailed for a similar scheme when he was governor of New Mexico. Indeed, one reason that officials in Jefferson County didn't know that the swaps they were signing off on were shitty was because their adviser on the deals was a firm called CDR Financial Products, which is now accused of conspiring to overcharge dozens of cities in swap transactions. According to a federal antitrust lawsuit, CDR is basically a big-league version of Bill Blount — banks tossed money at the firm, which in turn advised local politicians that they were getting a good deal. "It was basically, you pay CDR, and CDR helps push the deal through," says Taylor.

In the end, though, all this bribery and graft was just the table-setter for the real disaster. In taking all those bribes and signing on to all those swaps, the commissioners in Jefferson County had basically started the clock on a financial time bomb that, sooner or later, had to explode. By continually refinancing to keep the county in its giant McMansion, the commission had managed to push into the future that inevitable day when the real bill would arrive in the mail. But that's where the mortgage analogy ends — because in one key area, a swap deal differs from a home mortgage. Imagine a mortgage that you have to keep on paying even *after* you sell your house. That's basically how a swap deal works. And Jefferson County had done 23 of them. At one point, they had more outstanding swaps than New York City.

Judgment Day was coming — just like it was for the Delaware River Port Authority, the Pennsylvania school system, the cities of Detroit, Chicago, Oakland and Los Angeles, the states of Connecticut and Mississippi, the city of Milan and nearly 500 other municipalities in Italy, the country of Greece, and God knows who else. All of these places are now reeling under the weight of similarly elaborate and ill-advised swaps — and if what happened in Jefferson County is any guide, hoo boy. Because when the shit hit the fan in Birmingham, it *really* hit the fan.

For Jefferson County, the deal blew up in early 2008, when a dizzying array of penalties and other fine-print poison worked into the swap contracts started to kick in. The trouble began with the housing crash, which took down the insurance companies that had underwritten the county's bonds. That rendered the county's insurance worthless, triggering clauses in its swap contracts that required it to pay off more than $800 million of its debt in only *four* years, rather than 40. That, in turn, scared off private lenders, who were no longer -interested in bidding on the county's bonds. The banks were forced to make up the difference — a service for which they charged enormous penalties. It was as if the county had missed a payment on its credit card and woke up the next morning to find its annual percentage rate jacked up to a million percent. Between 2008 and 2009, the annual payment on Jefferson County's debt jumped from $53 million to a whopping $636 million.

It gets worse. Remember the swap deal that Jefferson County did with JP Morgan, how the variable rates it got from the bank were supposed to match those it owed its bondholders? Well, they didn't. Most of the payments the county was receiving from JP Morgan were based on one set of interest rates (the London Interbank Exchange Rate), while the payments it owed to its bondholders followed a different set of rates (a municipal-bond index). Jefferson County was suddenly getting far less from JP Morgan, and owing tons more to bondholders. In other words, the bank and Bill Blount made tens of millions of dollars selling deals to local politicians that were not only completely defective, but blew the entire county to smithereens.

And here's the kicker. Last year, when Jefferson County, staggered by the weight of its penalties, was unable to make its swap payments to JP Morgan, the bank canceled the deal. That triggered one-time "termination fees" of — yes, you read this right — $647 million. That was money the county would owe no matter what happened with the rest of its debt, even if bondholders decided to forgive and forget every dime the county had borrowed. It was like the herpes simplex of loans — debt that does not go away, ever, for as long as you live. On a sewer project that was originally supposed to cost $250 million, the county now owed a total of $1.28 *billion* just in interest and fees on the debt. Imagine paying $250,000 a year on a car you purchased for $50,000, and that's roughly where Jefferson County stood at the end of last year.

Last November, the SEC charged JP Morgan with fraud and canceled the $647 million in termination fees. The bank agreed to pay a $25 million fine and fork over $50 million to assist displaced workers in Jefferson County. So far, the county has managed to avoid bankruptcy, but the sewer fiasco had downgraded its credit rating, triggering payments on other outstanding loans and pushing Birmingham toward the status of an African debtor state. For the next generation, the county will be in a constant fight to collect enough taxes just to pay off its debt, which now totals $4,800 per resident.

The city of Birmingham was founded in 1871, at the dawn of the Southern industrial boom, for the express purpose of attracting Northern capital — it was even named after a famous British steel town to burnish its entrepreneurial cred. There's a gruesome irony in it now lying sacked and looted by financial vandals from the North. The destruction of Jefferson County reveals the basic battle plan of these modern barbarians, the way that banks like JP Morgan and Goldman Sachs have systematically set out to pillage towns and cities from Pittsburgh to Athens. These guys aren't number-crunching whizzes making smart investments; what they do is find suckers in some municipal-finance department, corner them in complex lose-lose deals and flay them alive. In a complete subversion of free-market principles, they take no risk, score deals based on political influence rather than competition, keep consumers in the dark — and walk away with big money. "It's not high finance," says Taylor, the former bond regulator. "It's low finance." And even if the regulators manage to catch up with them billions of dollars later, the banks just pay a small fine and move on to the next scam. This isn't capitalism. It's nomadic thievery.