Subprime Loans

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Abstract- *The subprime crisis in us is the result of large amount of loans made to people who could not afford them and excessive amount of money thrown into the mortgage arena by investors who are very eager for the high return. The crisis represents the other side of phase when a low rate of return interest, rising home prices and mortgage securization brought the huge gains. A number of factors like legislations like community reinvestment act, low rate of interest, mortgage brokers and lenders, rating agencies played their role in generating the crisis. Three important dimensions of subprime saga relate to poor regulation of investment banks, relaxation in lending standards led by greed in the regime of unbridled competition and failure of the asset market to realize the due from the defaulters.*

Keywords- mortgages, subprime crisis, housing bubble.

I. INTRODUCTION

A subprime loan is a type of loan offered at a rate above prime to individuals who do not qualify for prime rate loans. Quite often, subprime borrowers have been turned down by traditional lenders because of their low credit ratings or other factors that suggest they have a reasonable chance of defaulting on the debt repayment. In short prime loans are the loans offered to the borrowers who as a good credit rating histories and carries low rate of interest where as subprime loans are offered to the borrowers with bankruptcies, defaults, or low payment histories.

Prime and subprime mortgage

Prime mortgage	Subprime mortgage
• High income	• Low income
• secure job	• insecure job
• History of prompt and good credit rating	• History of default and bad credit rating
• Loan much less than value of borrowers home	• Loan close to value of borrowers home

Types of subprime lending: Subprime loans can be classified into four different types which are as follows:

- Adjustable rate subprime loans
- Fixed rate subprime loans
- Interest only subprime loans
- Dignity subprime loans

- **Adjustable rate subprime loans**: These are loans, which will have a fixed interest rate startlingly, and in a later stage, this rate may be changed t. The best example for this case is 2/24 loan. In his type of loan, there is a fixed interest rate for the first 2 months of a 30 month long repayable loan, and after the initial 2 years, the rate will get changed. The rate will be determined on the basis of different indices. However, there are loans, in which the interest rate will go on decreasing with time. In this type of subprime loans, there is generally an additional option for the borrower, wherein he can increase his credit score before the end of the flat rate period.

- **Fixed rate Subprime loans:** In this type of subprime loan, there is a fixed but higher rate of interest. This type of loans usually has a longer period for repayment, which may range between 40 and 50 years, unlike the normal 30 year period. This long term repayment model of this loan helps the borrowers with a low monthly payment as compared to the installments of the loan. However, the interest rates will be higher than most other types of loan.

- **Interest only Subprime loans:** This is a type of subprime loans, in which the payment of interest amount and the principal amount is divided into different periods. Initially, there will be a five, seven or 10 year period, in which the borrower will only pay interest amount. Then, after this period, the borrower will start paying back the principal amount of the loan. Many times, the borrower also has an option to pay the principal amount at the initial period if possible, but this is not mandatory in this type of subprime lending. This type of loans will be useful for borrowers having fluctuating earnings.

- **Dignity Subprime loan:** This is a new type of subprime loan. In this type of loan, the borrower has to pay a small down payment, which will equal to almost 10 % of the principal amount of the loan. And after the down payment, the borrower has to pay the installments at a higher interest rate for a specified period of time. If the payments are done correctly during this period of time, the balance amount of the loan is again calculated, and then on, the interest rate goes on decreasing to equal the prime rates at one point of time.

Why these subprime loans issued?

- For banks to earn more money by tapping defaulting customers.
- For young people who don't have enough money for down payment.
- For people who are having financial problems.
- For people who are discriminated against.

II. SUBPRIMECRISIS

Subprime crisis is a global and financial crisis.

This crisis was considered as worst financial crisis since 1929 crisis.

It was started from 2006 with a karch of the risky mortgage loans in USA.

Revealed to the world in February 2007 it turns into global financial crisis at the beginning of summer 2007.The main causes of subprime loans are of Up to until 2006, the housing market in the united states a flourishing due to that fact it is so easy to get an loan individual were taking financial loan with an expectation that they would be able to refinance their home loans.2005 was peak of subprime boom. At this time 1 in 5 mortgages were subprime loans.

However housing bubble has burst and housing prices reached the peak.

Real estate prices have rose steadily in the United States for decades, with slowdowns caused only by interest rate changes along the way. Prices increased as demand for homeownership through government sponsored programs increased, along with the general sentiment that owning real estate represents the American dream. Mortgages became available to a wider range of consumers with programs offered by Fannie Mae, Freddie Mac, which may have put money in the hands of some irresponsible homeowners who would later default on payments. Interest rates remained in an affordable range throughout the mid-1990s and early 2000s, making homeownership even more affordable. As with other investments, real estate couldn't possibly appreciate year over year at such a pace forever, and soon the bubble burst.

This collapse didn't happen overnight, but loud rumblings started to occur as subprime mortgages those made to consumers with less than perfect credit became 20% of the market in 2006, . Some banks made subprime mortgages their entire business, and in early 2008 they began to see late payments and defaults in such high numbers that many banks collapsed. Heavy subprime portfolios quickly brought down insurance companies such as AIG that had insured these mortgages. Pools of mortgages used for investments were defaulting, and institutions such as Lehman Brothers and Bear Sterns that underwrote, owned and sold many such investments saw drops in value so great they not only had to shut their doors but also brought down others. Meanwhile, the increased foreclosures began to bring down values of nearby homes, and the chain reaction spread across the country from 2008 to 2010.

- **Its impact on us:**

Between June 2007 and November 2008 American lost more than half quarter of their net worth.
Housing prices has dropped 20% from the 2006 peak.
The unemployment rose from 5% to 15%by 2009.
The total national debt rose from 66%GDP in 2008 over103% by end of 2012.
Residential private investment fell from 2006 pre-crisis of $800billion to $400 billion.

- **Impact on India:**

Stock market: on 10th October rs.250000 crores wiped out on a single day of India's stock market. A huge withdrawal from India's stock market was mainly by foreign institutional investors (FII).

India's trade: The foreign exchange reserves of country depleted by around $57 billion to 253 billion for week ended of October 31st.

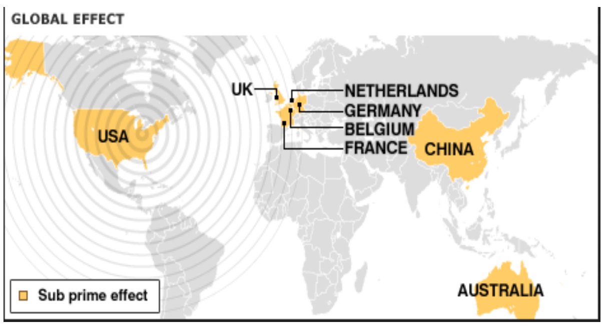
India's export: India's export ran into difficult times, since October. Manufacture sectors like leather, textiles, gems and jewelry were hit very hard because slump in the demand of us and Europe. Exports dropped to 1.5 billion from 12.7 billion while imports from 6.1 to 21.5 billion.

Handloom jewelry exports, tourisms: Reduction in demand in the Indian gems, jewelry, industry, handloom and tourism sector. Around 50000employed in jewelry industry lost their jobs a result of global economic meltdown. Indian tourism sector was badly affected as number of tourist following from Europe and USA decreased sharply.

This crisis affected 300rs crores handloom industry and exports dropped by 4.6%in 2007-2008, creating a wide spread of unemployment

Other sectors: Slowdown could be observed in automobiles sector the real estate segment comedown and same as happened in textiles as well.

- **Global impact:**



The impact of subprime crisis has repercussions beyond the United States. Losses are felt by investment banks even in Australia.

III. CONCLUSION

A variety of regulatory changes proposed by economist, politicians, journalists and business leaders to minimize the impact of current crisis and prevent recurrence. At last the subprime mortgage industry as vanished after the great recession but it is now reinvented as non prime loans.