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The Sub Prime Problem

What is Sub prime mortgage?

Sub prime lending, also called "B-Paper", "near-prime" or "second chance" lending, is a general term that refers to the practice of making loans to borrowers who do not qualify for market interest rates because of problems with their credit history. Sub prime loans or mortgages are risky for both creditors and debtors because of the combination of high interest rates, bad credit history, and murky financial situations often associated with sub prime applicants. A sub prime loan is one that is offered at a rate higher than A-paper loans due to the increased risk.

Sub prime lending encompasses a variety of credit instruments, including sub prime mortgages, sub prime car loans, and sub prime credit cards, among others.

Sub prime lending is typically defined by the status of borrowers. A sub prime loan is, by definition, a loan made to someone who could not qualify for a more favorable rate. Sub prime borrowers typically have low credit scores and either a limited credit history, or histories of payment delinquencies, charge-offs, or bankruptcies. Because sub prime borrowers are considered at higher risk to default, sub prime loans typically have less favorable terms than their traditional counterparts. These terms may include higher interest rates, regular fees or an up-front charge.

Proponents of the sub prime lending in the United States have championed the role it plays in extending credit to consumers who would otherwise not have access to the credit market. But opponents have criticized the sub prime lending industry for predatory practices such as targeting borrowers who did not have the resources to meet the terms of their loans over the long term. These criticisms have increased since 2006 in response to the growing crisis in the U.S. sub prime mortgage industry, wherein hundreds of thousands of borrowers have been forced to default and several major sub prime lenders have filed for bankruptcy.

Crises

Beginning in late 2006, the U.S. sub prime mortgage industry entered what many observers have begun to refer to as a meltdown. A steep rise in the rate of sub prime mortgage foreclosures has caused more than two dozen sub prime mortgage lenders to fail or file for bankruptcy, most prominently New Century Financial Corporation, previously USA's second biggest sub prime lender. The failure of these companies has caused stock prices in the $6.5 trillion mortgage bundled securities market to collapse, threatening broader impacts on the U.S. housing market and economy as a whole. The crisis is ongoing and has received considerable attention from the U.S. media and from lawmakers.

Observers of the meltdown have cast blame widely. Some have highlighted the predatory practices of sub prime lenders and the lack of effective government oversight. Others have charged mortgage brokers with steering borrowers to unaffordable loans, appraisers with inflating housing values, and Wall Street investors with backing sub prime mortgage securities without verifying the strength of the underlying loans. Borrowers have also been criticized for entering into loan agreements they could not meet. Many accounts of the crisis also highlight the role of falling home prices since 2005. As housing prices rose from 2000 to 2005, borrowers having difficulty meeting their payments were still building equity, thus making it easier for them to refinance or sell their homes. But as home prices have weakened in many parts of the country, these strategies have become less available to sub prime borrowers.

Several industry experts have suggested that the crisis may soon worsen. Lou Ranieri, formerly of Salomon Brothers, considered the inventor of the mortgage backed securities market in the 1970s, warned of the future impact of mortgage defaults: "This is the leading edge of the storm. … If you think this is bad, imagine what it's going to be like in the middle of the crisis." There Is a possibility of five million foreclosures that may occur over the next several years as interest rates on sub prime mortgages issued in 2004 and 2005 reset from the initial, lower, fixed rate to the higher, floating adjustable rate or "Adjustable rate mortgage". Other experts have raised concerns that the crisis may spread to the so-called Alternative-A (Alt-A) mortgage sector, which makes loans to borrowers with better credit than sub prime borrowers at not quite prime rates.

Some economists, including former Federal Reserve Board chairman Alan Greenspan, have expressed concerns that the sub prime mortgage crisis will impact the housing industry and even the entire U.S. economy. In such a scenario, anticipated defaults on sub prime mortgages and tighter lending standards could combine to drive down home values, making homeowners feel less wealthy and thus contributing to a gradual decline in spending that weakens the economy.

Conclusion

This is proving to be more like a LTCM (Long term Capital Management, a Mortgage Fund that went bust like the present Bears Funds), a recession in the US cannot be ruled out and if there is a recession in US entire world economy would be depressed. India is not completely dependent on the US and the internal demand is enough to fuel the growth in India for at least for next 10 years. This crisis may present us a very good buying opportunity in

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