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| Unknown Catastrophe |
| Subprime Mortgage Crisis |
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Fall 2011

Business 1040 ~ Ethics @ Work

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**INTRODUCTION**

This topic is one of those that will continue to be discussed for ages and everyone has a different outlook on what happened. The term subprime refers to the credit characteristics of individual borrowers. (Wikipedia) Subprime loans are typically created for people who have low to bad credit activities some of which might consist of; late payments, bounced checks, bankruptcies, and anything else that could affect your credit score. Unfortunately, some people get into a house they couldn’t afford in the first place just because the paperwork was filed wrong or submitted incorrectly. People, who get involved with subprime loans, have a higher risk of defaulting on their loans which will result in foreclosure.

I will be discussing the rise and fall of the subprime mortgage crisis as well as talking about different statistics. Some of those statistics will be explaining ratios of lower-quality mortgages. What the risks that will be involved are; both high & low. I will also be giving you more information about The Fuel That Fed The Subprime Meltdown.

There are some very important concerns that need to be explained clearly in this paper, and they are:

1. ARM’s (adjustable rate mortgages)
2. Piggyback Loans (1st & 2nd Mortgages)
3. “Creative financing” and borrower’s choice of payment options

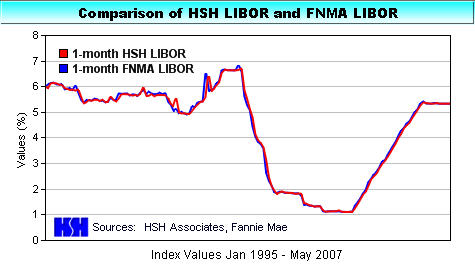
The subprime mortgages were causing interests rates to increase which instead of saving money; people were scrounging around for more money to spend. Types of mortgages like this persuade people to start out with a below market interest rate for a prearranged time frame and then they will deal with a separate market interest rate for the rest of the time they will have their mortgage. Some people are not able to afford the payments as soon as their time frame runs out. In this case they either plan ahead to refinance their house before the time runs out or figure out how they are going to pay the remainder of their mortgage payment. Most of the time refinancing a home isn’t as easy as it sounds when lenders explain it and can become more complex and more home loans fall into default status.

**FINDINGS**

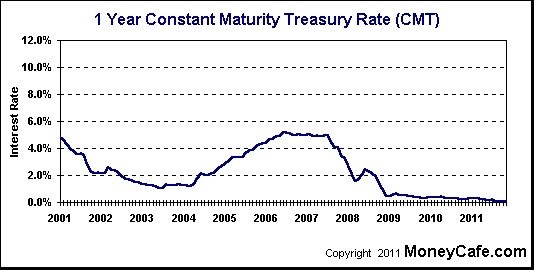
***Adjustable Rate Mortgages***

This type of mortgage has different titles it might be known by. For example; variable-rate mortgage and/or tracker mortgage. These are among the most common here in the United States when someone is trying to buy a house or even get a loan. Adjustable Rate Mortgage is a mortgage loan with the interest rate on the note of your house that is periodically adjusted based on an index which reflects the cost to the lender of borrowing on the credit markets. The loan may be offered at the lender's standard variable rate/base rate. (Wikipedia) Some commonly used indexes are (LIBOR) or London Interbank Offered Rate and the CMT U.S. Constant Maturity Treasury.

London Interbank Offered Rates are an interest rate at which banks can borrow funds, in marketable size, from other banks in the London interbank market. The LIBOR is fixed on a daily basis by the British Bankers' Association. The LIBOR is derived from a filtered average of the world's most creditworthy banks' interbank deposit rates for larger loans with maturities between overnight and one full year. (Investopedia)



U.S. Constant Maturity Treasury is an average yield on United States Treasury securities adjusted to a constant maturity of 1 year, as made available by the Federal Reserve Board.  Yields are interpolated by the United States Treasury from the daily yield curve. This curve, which relates the yield on a security to its time to maturity, is based on the closing market bid yields on actively traded Treasury securities in the over-the-counter market. Here is a chart to show an example of a CMT index. (MoneyCafe.com, 2011)



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| **1 Year Constant Maturity Treasury Rate** | | | | | | | | | | | |
| **Month** | **2001** | **2002** | **2003** | **2004** | **2005** | **2006** | **2007** | **2008** | **2009** | **2010** | **2011** |
| **Jan** | 4.81% | 2.16% | 1.36% | 1.24% | 2.86% | 4.45% | 5.06% | 2.71% | 0.44% | 0.35% | 0.27% |
| **Feb** | 4.68% | 2.23% | 1.30% | 1.24% | 3.03% | 4.68% | 5.05% | 2.05% | 0.62% | 0.35% | 0.29% |
| **Mar** | 4.30% | 2.57% | 1.24% | 1.19% | 3.30% | 4.77% | 4.92% | 1.54% | 0.64% | 0.40% | 0.26% |
| **Apr** | 3.98% | 2.48% | 1.27% | 1.43% | 3.32% | 4.90% | 4.93% | 1.74% | 0.55% | 0.45% | 0.25% |
| **May** | 3.78% | 2.35% | 1.18% | 1.78% | 3.33% | 5.00% | 4.91% | 2.06% | 0.50% | 0.37% | 0.19% |
| **Jun** | 3.58% | 2.20% | 1.01% | 2.12% | 3.36% | 5.16% | 4.96% | 2.42% | 0.51% | 0.32% | 0.18% |
| **Jul** | 3.62% | 1.96% | 1.12% | 2.10% | 3.64% | 5.22% | 4.96% | 2.28% | 0.48% | 0.29% | 0.19% |
| **Aug** | 3.47% | 1.76% | 1.31% | 2.02% | 3.87% | 5.08% | 4.47% | 2.18% | 0.46% | 0.26% | 0.11% |
| **Sep** | 2.82% | 1.72% | 1.24% | 2.12% | 3.85% | 4.97% | 4.14% | 1.91% | 0.40% | 0.26% | 0.10% |
| **Oct** | 2.33% | 1.65% | 1.25% | 2.23% | 4.18% | 5.01% | 4.10% | 1.42% | 0.37% | 0.23% | 0.11% |
| **Nov** | 2.18% | 1.49% | 1.34% | 2.50% | 4.33% | 5.01% | 3.50% | 1.07% | 0.31% | 0.25% | 0.11% |
| **Dec** | 2.22% | 1.45% | 1.31% | 2.67% | 4.35% | 4.94% | 3.26% | 0.49% | 0.37% | 0.29% |  |
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***Piggyback Loans (1st & 2nd Mortgages)***

A piggyback loan occurs when a borrower takes out two loans simultaneously: one for 80 percent of a home’s value, and the other to make up for whatever cash is lacking to make up a 20 percent down payment. This is used as an alternative to private mortgage insurance. A piggyback loan is also known as a second trust loan. Essentially, a piggyback loan helps homebuyers who don’t have the traditional 20 percent down payment when applying for a mortgage.

Some of the reasons why Piggyback loans are good are because they are put in place to help people get into a nice home who may not have the large down payment. So when more than one company is responsible for the loan, then it helps out with finances and down payments. People who have this type of loan usually have a better chance at getting the loan they desire then someone with a single loan.

Some of the reasons to think long and hard before choosing this type of loans are; because you have to remember that the more lenders you have, the more interest rates you have too. You also have to keep track of what goes to whom and how much you owe + interest. I know with the issues that have been going on with our house that part is a huge hassle. The lender who is only financing 80% of the loan amount might be willing to drop their rates a bit, but the second lender-the one who is only financing 5% to 20% of the loan-doesn’t see much benefit from lending the money unless he can actualize a high interest return. (Mortgage News Daily) Another downside to getting a Piggyback Loan is; most of the time, you will have a hefty balloon payment at the end of your loan cycle that you will have to pay. This payment is usually double, if not larger, than your regular mortgage payment normally is. Unless you plan for this payment it could hit you and your family pretty hard.

With our situation, my grandfather decided we needed this house and he couldn’t just let us be to get the house we wanted with the lender we were working with already. So he went ahead and worked with a lender and then he got a second lender which was my uncle. It has been a nightmare since we got the house and now we have a huge payment at the end of our loan period or if we decide to sell the house early.

Increasing foreclosure rates increases the inventory of houses offered for sale. The number of new homes sold in 2007 was 26.4% less than in the preceding year. By January 2008, the inventory of unsold new homes was 9.8 times the December 2007 sales volume, the highest value of this ratio since 1981. Furthermore, nearly four million existing homes were for sale,of which almost 2.9 million were vacant.This overhang of unsold homes lowered house prices. As prices declined, more homeowners were at risk of default or foreclosure. House prices are expected to continue declining until this inventory of unsold homes (an instance of excess supply) declines to normal levels. A report in January 2011 stated that U.S. home values dropped by 26 percent from their peak in June 2006 to November 2010, more than the 25.9 percent drop between 1928 to1933 when the Great Depression occurred. (<http://en.wikipedia.org/wiki/Subprime_mortgage_crisis>)

***“Creative financing” and borrower’s choice of payment options***

This is a term used widely amongst real estate investors to refer to non-traditional means of real estate financing, or financing techniques not commonly used. The goal of creative financing is generally to purchase, or finance a property, with the buyer/investor using as little of his/her own money as possible, otherwise known as leveraging, OPM (Other People's Money). Using these techniques an investor may be able to purchase multiple properties using little, or none, of their "own money". (Wikipedia, July 21, 2011) There are several different types of creative financing options that are available. You have hard money loans, private mortgages, simultaneous closings, subject to transaction, land trust, and short sale. Just reading the name alone seems kind of shady like something unethical is bound to happen. One of the most common of these loans is the piggyback loan I was just discussing in a prior section.

**CONCLUSIONS**

In a matter of weeks over a dozen of mortgage lenders file for bankruptcy due to all these issues with the housing market and paperwork. We are currently knee-deep in a financial crisis that centers on the U.S. housing market, where fallout from the frozen subprime mortgage market is spilling over into the credit markets, as well as domestic and global stock markets.  
([http://www.investopedia.com/articles/07/subprime-overview.asp#ixzz1fvEn9BNn](#ixzz1fvEn9BNn))

Most of the research that you will do usually shows someone saying that there is nothing essentially immoral about the responsibility of putting down collateral for payments owed. In the end no matter how you finance you dreams for the future there are risks that need to taken into account. Sometimes things go great without any issues they even turn out for the best in most cases and sometimes things go horribly wrong to where you could lose everything you every worked for.

**RESOLUTION**

In today’s economy and our changing world everyone spends more time blaming something or someone else long before they even think about what went wrong. Most people don’t realize that most of the downfalls that happen especially when it comes to their dream homes and the paperwork that was involved in getting that home. They act like they had no part in the down turn of their dreams or why things went so bad. In the long run they found the house, filled out the paperwork and signed on the dotted line. If they didn’t read the fine print or ask any questions about the big picture then downfall of their dreams is partially their fault too.

Mortgage companies and lenders are also responsible because they should be held morally in account for these actions to. There are some very shady lenders who will do everything they can to get you into a home but they don’t tell you that not every part is legal or in order. For example in our situation, the mortgage lenders agent or middle man did not process the paperwork for our house properly. He put all the right paperwork into the system but fudged the figures so that it shows that we have more money they we do. The paperwork shows that we had my grandpa’s income, my parents, mine and my brother’s incomes. When in reality we only had my parent’s income, which unfortunately my dad had just gotten a new job at that time. He added my income which was monthly disability funds and my brothers who were working for a flooring company at the time. We don’t get a dime from my grandfather’s income, because he needs that to pay his own bills.

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