FINANCE

A Primer on Subprime

by C.D. Moriarty

The mortgage crisis. The economy. Falling home prices. These are the issues on evening news. All the information leaves one's head spinning and none the wiser as the talk centers on rates, subprime mortgage issues and investing. The important question is what does it mean to us here in Vermont?

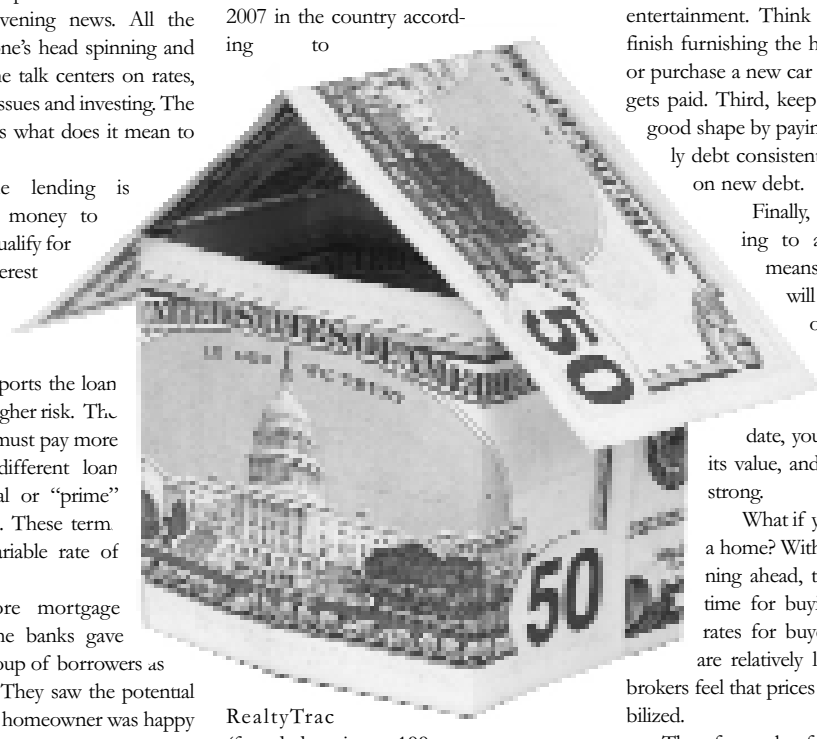
First, subprime lending is defined as loaning money to people who do not qualify for the best market interest rates. These people usually do not have the credit score that supports the loan and therefore are a higher risk. The subprime borrower must pay more interest and have different loan terms than the ideal or "prime" candidate for a loan. These terms usually include a variable rate of interest.

More and more mortgage companies and some banks gave mortgages to this group of borrowers as housing prices rose. They saw the potential to make money. The homeowner was happy to buy a home with a minimal down payment, despite their poor credit history. This worked for everyone involved for a time.

When interest rates started to go up, monthly mortgage payments went up for the variable interest borrower. Rather than paying the $1100 a month they could afford, their loan could now be $1500 a month. This increase without a comparable increase in wages meant that something else in the monthly budget must be reduced or the mortgage could not be paid. For consumers already stretched to pay bills, the increase sent them reeling.

According to CNN the highest share of subprime lending took place in metro areas where housing prices were rising the fastest. Bakersfield, Texas had the highest percentage of subprime loans at 26.8 percent. In California cities, 20 percent of the loans were subprime.

The subprime crisis is a debacle affecting the country. However, the direct impact in Vermont is less severe in comparison. In Burlington only four percent of the loans were subprime. Vermont had the lowest number of foreclosures in the first of half of 2007 in the country according to RealtyTrac (founded in 1996, RealtyTrac, Inc. is the third largest real estate Web site and a leading online marketplace on foreclosure properties and other properties for sale, with 3 million visitors per month.)



Still even one foreclosure is a disaster for a family. So what if you are one of those finding the payments on your home are beginning to stretch your income and bringing you to the brink? Do not wait till the stress, the lack of money and the mortgage company all catch up with you. You make the first move. Initiate a call to your lender. See if you qualify for any of the recent legislation like the Mortgage Debt Relief act passed in Congress on December 18th. You are always in a better position if you call your lender before there is a problem. They do not want to foreclose on your home and typically will work with you to find a solution.

Do everything you can to keep your mortgage payments on time, even if it means changing your lifestyle. First, figure if your family can create more income through a second job or maybe renting a room in your home. Second, cut back in spending for new clothes, eating out and entertainment. Think trade-offs – do not finish furnishing the house, take vacations, or purchase a new car so that the mortgage gets paid. Third, keep your credit score in good shape by paying your other monthly debt consistently and by not taking on new debt.

Finally, investigate refinancing to a fixed rate, which means fixed payments. You will have a better chance of making this happen if you have been on time with your payments to date, your house has retained its value, and your credit rating is strong.

What if you are looking to buy a home? With some practical planning ahead, this could be a good time for buying a home. Interest rates for buyers with good credit are relatively low. Local real estate brokers feel that prices in Vermont have stabilized.

The aftermath of the subprime mortgage crisis affects the new buyer and the person hoping to refinance. According to loan officer Buddy Singh at Spruce Mortgage in Burlington, "Tight credit is tight credit for everybody." He recommends planning ahead by talking now to the mortgage broker or bank even if you are not planning to buy until late spring. By getting a pre-approval now or finding out if your credit score could use improvement, you will be better prepared to begin the search for a home.

Be prepared for a mortgage process to take longer than in the past. And be patient with the added requests to support your income, assets and the value of your home. "Everything is being questioned by the mortgage company, even the home appraisal values," Singh says.

In the meantime, save for the house you want. Having a significant down payment of 10 percent or more, a credit score of 680 or above, and the ability to document your income are ways of having this housing market work for you.

Finally the subprime crisis has an effect on the wider economy. In the short term, the government is changing some rules and the effect is making credit more difficult for all to obtain. Debt for business investment and growth is also more difficult to acquire. The home mortgage industry is coming under more scrutiny and regulation.

This all has a noticeable effect on businesses and the stock market. Mortgage companies have been closing down or at the very least, declaring huge loses. Other companies are being bought out or merging as with Bank of America and Countrywide. In addition, the stock market is reeling in part due to the fact that the loans that were sold to Wall Street investment firms are now feeling the effect of foreclosures. The ripple effect could continue through to other debt if credit cards, school loans and other consumer debt become overwhelming for people to pay as they are faced with their increasing mortgages. This is another long-term impact spreading to Vermont along with tightened credit.

> **"The subprime crisis has an effect on the wider economy."**

Next time you hear subprime, you will know that it means so many different things to different people. Most importantly, you will know what it means to you.

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