



## [A Primer on Subprime Mortgage Loans, Subprime Lenders, Alt-A Mortgage Loans, Alt-A Mortgage Lenders, Subprime Credit Cards, and Subprime Car Loans.](#)

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### Subprime Mortgages

It is universally desirable to own a home. Homeownership is the financial foundation of the economy, and the personal financial foundation of most people.

Several years ago, in order to increase the level of homeownership in the country, mortgage lenders began making mortgage loans to borrowers who had less than perfect credit histories or who were new to the credit market. Because of the increased risk present in these loans, they have been referred to as "subprime" mortgage loans.

Subprime mortgage loans refer to mortgage loans made to borrowers who have a less than prime credit condition. This less than prime credit condition may be due to a history of past credit or financial problems or simply be reflective of the fact that a person may be new to the world of credit and not have established a credit history.

Borrowers with credit scores of 600 and below (650 and below, by some definitions) often will find a subprime mortgage as their only source of mortgage financing. Late payment of bills or declaring bankruptcy could very well place borrowers in a situation where they can only qualify for a subprime mortgage. Accordingly, it is often advisable for people with low credit scores or temporary credit problems to wait for a period of time and build up their credit scores before applying for a mortgage in order to insure they are eligible for a conventional mortgage.

There are other factors that may cause a borrower to fall into the subprime category. For example, some borrowers might be classified as subprime despite having an excellent credit history because they choose not to provide the lender with the opportunity to verify their income or assets stated in the loan application process. Loans of this type are called "stated income" loans or "stated asset" (SISA) loans or "no income-no asset" (NINA) loans. Due to a subprime lender's perceived higher risk in making these types of loans, the borrower is considered a subprime credit.

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Subprime lenders generally regard subprime lending as a "numbers game" where they have to go through many prospective borrower applications in order to weed-out unacceptable risks and determine which applicants represent an acceptable level of risk. In order to deal with the large number of applications, subprime lenders often will use a credit scoring system to determine which applicants are acceptable risks and for which loan programs they may qualify.

In addition to using credit scoring programs to help them sort out the many applications that they receive for subprime loans, subprime lenders often make extensive use of television and Internet advertising to help bring in subprime loan applications. Also, subprime lenders buy lists of potential subprime borrowers and solicit their business by mail or over the Internet.

The reason that subprime lenders go to the trouble of examining large numbers of applications and determining which ones represent acceptable levels of risk is that subprime lenders charge higher interest rates and fees than those charged for non-subprime mortgage loans.

As of the first half of 2007, approximately 25% of mortgage originations in the United States are classified as subprime.

Subprime mortgage loans tend to have a shorter time horizon and fewer opportunities to refinance when interest rates fall than do traditional non-subprime loans.

### Alt-A Mortgage Loans

Alt-A mortgage loans are considered to be of a higher quality than subprime mortgage loans but not as high quality as a prime mortgage loan that would qualify for sale to Fannie Mae or Freddie Mac. They can share many structural qualities with subprime loans, but the pricing of Alt-A loans is generally somewhat more favorable to a borrower than that of a subprime loan.

Examples of a typical Alt-A borrower would be one who has an acceptable credit rating but may have trouble verifying income, employment, or assets.

### Subprime Mortgage Payment Reset Concerns

The greatest concern regarding subprime mortgages is that the vast majority of them are adjustable rate loans that start out with low "teaser" interest rates or low "teaser" monthly payment amounts that typically expire after the first year or two.

When this "teaser" period expires, the interest rate or payment amount can increase, often resulting in the subprime mortgage borrower being placed in the position of being unable to make the new monthly payments. The typical results are:

1. The subprime lender has to foreclose on the subprime mortgage, or

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2. The subprime lender has to enter into a workout arrangement with the borrower which usually results in the subprime lender writing down the value of the loan on their books.

In either of these two possibilities, the subprime lender winds up with an investment value that is less than what was reflected on their books before the subprime loan went into default.

### Subprime Car Loans

There are estimates that approximately \$50 billion in subprime car loans were originated in 2006, the most recent year for which reliable information is available. This accounts for over 19% of all car loans originated during that period.

Subprime car loans include some features that make them as risky as subprime mortgage loans, and some features that make them less risky. For example, mortgage loans are secured by an asset that generally appreciates in value, whereas a car loan is secured by an asset that generally depreciates in value. On the other side of the ledger, mortgage loans are often repaid based upon a variable interest rate and variable payment amount; whereas car loans are more likely to be on a fixed rate and fixed payment amount.

Comparing subprime car loans to prime car loans, we find that subprime car loans are usually repaid over a longer term, require a lower down payment, and are made for a higher loan-to-value ratio than are prime car loans.

In the final analysis, it is believed that subprime car loans carry slightly less risk than do subprime mortgage loans since the retention of the car is often critical in order for the borrower to continue to work. Even so, there is always the possibility that the borrower could walk away from the car and subprime car loan and obtain transportation through another subprime car loan arrangement.

### Subprime Credit Cards

Many of the issues of subprime mortgage lending apply as well to subprime credit cards. Today, about 20% of the credit cards issued in the United States are considered to be of subprime quality.

Today, the credit card industry divides customers into the "prime" and "subprime" markets. Borrowers with a credit score in the top tier (and these tiers vary from lender to lender and are adjusted from time to time) may receive a credit card with a line of credit at an interest rate around 12%. Borrowers with a slightly lower credit score may receive a credit card with a line of credit at an interest rate of 15%, and a borrower with an even lower credit score may receive a credit card with a credit line at an interest rate around 17%. These are all considered non-subprime credit card customers.

Interest rates on subprime credit cards can be anywhere in a range from 20% to as high as 35%

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or so, depending upon the credit history of the borrower. In addition, lenders charge various fees, such as an annual fee and an account maintenance fee, to help offset their increased risk.

Subprime credit card lending began in the 1990s to allow subprime lenders to provide credit cards to customers with less than perfect credit and profit from the higher interest rates and fees that subprime lenders charge for these credit cards. The subprime credit card industry's market goal was to provide a credit card with a line of credit to customers with credit scores in the 500s, little or no credit history, those coming out of a personal bankruptcy and anyone else with a recent history of credit or financial problems.

Subprime credit cards offered to subprime borrowers typically require no security deposit, as do secured credit cards. Credit limits start out very low compared to those in the non-subprime credit card industry, typically in the \$100 to \$500 credit limit range. Fees and interest rates are much higher than those for non-subprime credit cards. Likewise, the effect of some terms can be magnified due to the small credit line size. For example, take an overlimit fee of \$29.00. This fee is of course a much greater percentage for a subprime credit card line of \$500 than it would be for a non-subprime credit card of \$5,000.

With these greater rewards for subprime credit card lenders come greater risks. It is reported that subprime credit card companies are writing off losses in the 15% to 17% range versus the average industry loss rate of 6.5%, according to CardWeb; and delinquency rates for subprime card companies average around 10% while those for the rest of the lending industry average around 5%.

Subprime credit card issuers use mass marketing techniques to bring in customers. Mail and Internet new account solicitations exceeded 5 billion in 2006, and were up dramatically from the total in 2005.

### Secured Subprime Credit Cards

Those with the lowest credit scores and histories may still qualify for a secured subprime credit card. Essentially, even though a secured subprime credit card looks and, in terms of making purchases, acts like a regular credit card, it is basically a pre-paid card wherein the customer makes a "security deposit" to insure the payment of charges made with the secured subprime credit card.

Actually, the term "subprime" is typically not included in the term of art when discussing secured credit cards; but make no mistake about it, one only has to take a look at the terms of a secured credit card to see that it is a subprime credit card. Typical secured credit card terms include a hefty (in relation to the "credit line") annual fee and require a minimum deposit of from \$99 up to \$5,000 depending upon the size of the "credit line" granted.

Despite their onerous terms, often a secured credit card is used as the first step for someone who needs to reestablish their credit.

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### Debit Cards

Debit cards carry the Visa or MasterCard name and give you the privilege of seeing money fly out of your checking account as soon as you make a purchase. In this way, a debit card is similar to a secured credit card except that the secured credit card essentially pays for purchases from the deposit you made earlier.

Managing a debit card that really does not offer you any credit, and coordinating all of the purchases that you make with your debit card with all of the checks that you write is a management nightmare.

Banks love debit cards because they eliminate the float that customers generally enjoy between the time a purchase is made and the time that the purchase has to be paid for, i.e., when you pay your credit card bill.

About the Author - Expert Witness and Expert Witness Consultant Number 74

Expert Number 74 provides expert consultation, fact examination and analysis, advice, Affidavits, Declarations, reports, and sworn testimony at deposition and in court for parties engaged in litigation involving subprime mortgage lending, Alt-A mortgage lending, subprime car loans, subprime credit cards, and all areas of banking and finance.

Expert Number 74's expert witness experience and background includes over 365 cases for plaintiffs and defendants nationwide, 93 testimonies, and 10 courthouse settlements in all areas of banking, finance, FACTA issues, real estate, economic damages, identity theft, business valuation, intangible asset valuation, and many related matters going back to 1989. Expert Number 74 is privileged to be listed in the databases of recommended expert witness consultants of both the Defense Research Institute and the American Association of Justice.

Expert Number 74's clients have included 8 of the top 10 banks in the country, 27 of the country's top 250 law firms, and numerous governmental clients including many banking regulators (FDIC, RTC, FSLIC, and others), IRS, USAID, U.S. Air Force, State of New York, State of Texas, World Bank, International Accounting Standards Board, and hundreds of others.

Expert Number 74's employment experience includes Citicorp and entities that are now JPMorgan Chase Bank, Bank of America, Ford Motor Credit, and Regions Financial, as well as a two-year stint as a high-level governmental financial institution regulator.

Expert Number 74 holds a B.A. degree from the University of Alabama, and completed postgraduate education at Alabama, the University of Houston, Southern Methodist University, Spring Hill College, and the Harvard Business School.

In addition to subprime mortgage and subprime credit card litigation consulting and other banking and finance-related litigation consulting, Expert Number 74 provides consulting services in many additional areas including business valuations, business plan writing, feasibility studies,

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marketing studies, anti-money laundering policies and procedures, policy and procedure manuals for financial institutions and other businesses, merger and acquisition due diligence and assistance, research, and many other related areas.

As part of this expert's wide-ranging consulting activities, Expert Number 74 has been called on by clients in 22 countries for work assignments involving over 50 countries.

Expert Number 74 is widely published on banking and financial subjects, and is often sought out by the media for interviews and comments.

Expert Number 74 serves clients worldwide from his office in the metro Atlanta, Georgia USA area.

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