Advantages and Disadvantages of Subprime Mortgages

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**Introduction**

 Subprime mortgages are types of mortgages issued to individuals whose poor credit rating does not give them the opportunity to access conventional mortgages. These types of mortgages come with advantages and disadvantages to both the borrowers and issues. This paper will discuss the advantages of subprime mortgages from the perspectives of borrowers and lenders.

**Advantages of Subprime Mortgages**

 Subprime mortgages come with wide scale benefits to both borrowers and lenders. To begin with, the first major benefit that borrowers accrue from this type of mortgage is its ease of approval. Subprime mortgages unlike conventional mortgages do not need a lot of formalities to approve. In fact, companies which issue subprime mortgages do not concentrate at all on formalities that are meant to depict the credit rating of an individual. The ease of approval means that subprime mortgages can be acquired within a shorter period in that the conventional mortgages; this is suitable for borrowers who could have urgent need for money. In addition; subprime mortgages provide a relief to people with low credit rating and who may be denied mortgages from other financial institutions owing to low credit rating. For a borrower to qualify for a subprime mortgage he or she does not have to meet the credit threshold set by Fair Isaac and Company FICO, this ensures that individuals can still have their financial needs met despite having low credit rating (Demyanyk & Van Hemert 2011).
 Another advantage of subprime mortgage is their high usefulness in debt settlements for people in high debt. Such people are hindered from accessing conventional mortgages by their debts; it would mean that if it were not for subprime mortgages, such people would continue drowning in mortgage loans. Individuals can access subprime mortgages to pay for their outstanding mortgage loans; after which they can now focus on paying for the subprime loan; this way, such individuals are able to increase their credit rating through time. Therefore, subprime mortgages provide an opportunity to people with low credit rating to improve their credit worthiness (Kregel 2008).

Subprime Mortgages also have outstanding benefits to financial institutions which issue them. These types of mortgages are issued at very high interest rates in comparison to conventional mortgages. The interest ceiling for subprime mortgages is very high, and it allowable by the government. The high interest rates are meant to relief the issue of the burden of risk that comes with issuing mortgages to persons with low credit rating. This means that institutions which issue subprime mortgages stand to gain more returns from the issue in comparison to institutions which issue ordinary mortgages. The high interest rates ensured that returns from borrowers who default the mortgages are covered. In addition, the mortgages are issued in good faith and there are very limited chances of default. Therefore, subprime mortgage issuers stand to benefit more from the mortgages in comparison to conventional mortgage companies. For instance, before the bursting of the housing bubble in 2008, organizations that specialized in subprime mortgages had realized high levels of returns (Demyanyk & Van Hemert 2011).

**Disadvantages of subprime mortgages**

 Despite the advantages that come with subprime mortgages they have various disadvantages to borrowers and lenders. The major disadvantage of subprime mortgages to borrowers is that they attract very high interest rates in comparison to conventional mortgages. This means that borrowers of subprime mortgages will end up paying more in comparison to if they took ordinary mortgages. Therefore, subprime mortgages come with a higher financial burden to borrowers in comparison to conventional mortgages. Another disadvantage of subprime mortgages is that they could put borrowers in a debt trap. The mortgages enable borrowers to access credit even when their credit rating is low; this could tempt the borrowers to borrow more than they can pay which could lead them to bankruptcy and insolvency (Purnanandam 2011).

 The major disadvantage of subprime mortgages to lenders is that the lenders stand at a very high risk of losing the funds invested since they mortgages are issued to persons of low credit rating. There is a very high chance of subprime mortgages borrowers defaulting, hence the mortgages pose a high financial risks to issuers. The second disadvantage of subprime mortgages to lenders is that few or no insurance companies will be ready to underwrite such loans; this means that in a case of borrowers defaulting, the issuers will have to bear all the financial loses realized (Kregel 2008).

**Responsibility of borrowers, lenders and government in subprime mortgages**

The responsibility of borrowers in subprime mortgages is to ensure they pay the mortgages in time; therefore, they should only borrow amounts that they can pay in time. The responsibility of lenders is to ensure that they should not charge more than warranted interest rates for the mortgages. The role of the government is to protect the interests of lenders and borrowers. For instance, it should ensure that borrowers are not charged more than warranted interests, and ensuring that there systems of ensuring borrowers pay for the mortgages borrowed; through having legislations that govern the subprime mortgages market (Purnanandam 2011).

**Conclusion**

 In conclusion, it is apparent that subprime loans have both advantages and disadvantages to borrowers and lenders; which must be considered before the issue or borrowing of subprime loans. Also, for effectiveness of the subprime mortgages market, all the players including borrowers, lenders and the government must effectively execute their responsibilities.

References

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