

Ask the Advisor

I've heard a lot about subprime loans. What is a subprime loan and how do I know if I have one?

Lynn in Boscawen



Subprime lending is simply the practice of making loans or extending credit to individuals who are considered to be risky borrowers, or more likely than average *not* to repay a loan. Since there is more risk that the borrower will not repay the loan, the lender charges higher interest and fees on the loan.

While the definition of a subprime borrower varies, the borrower generally has a low credit score, a history of making late payments or has been a party to foreclosure, repossession or bankruptcy.

In the best-case scenario, subprime lending allows those who might otherwise not get loans or credit to do so, and those who make the loans to earn more for taking the added risk.

In the worst-case scenario, borrowers misrepresent themselves or

borrow beyond their means, while unscrupulous lenders break prudent lending rules, fail to properly explain confusing loan terms, charge unreasonably high interest rates or charge excessive fees.

The current subprime fiasco is a result of the growth of subprime lending, much of it government-mandated, compounded with questionable borrowing and lending practices and more exotic loans with variable interest rates and variable repayment schedules.

Add to that recipe for disaster, the current real estate environment and variable interest rate loans, and the result is a rash of subprime borrowers in foreclosure with many subprime lenders going bankrupt.

The subprime debacle on

Wall Street is a different matter. Many subprime loans were packaged into complicated investment instruments that were highly leveraged and unrealistically overvalued.

When the bottom fell out, there was very little real underlying value. The end result for Wall Street investors, billions lost.

Fortunately, most loans are not subprime and many that are were acquired and written responsibly.

The wild west days of subprime lending are likely over. In the future, subprime loans will be heavily regulated, harder to make and harder to get, with far fewer foreclosures and bankruptcies.

While most loans are not subprime, the only way to really know for sure if a questionable loan is categorized as subprime is to check with the lender.

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