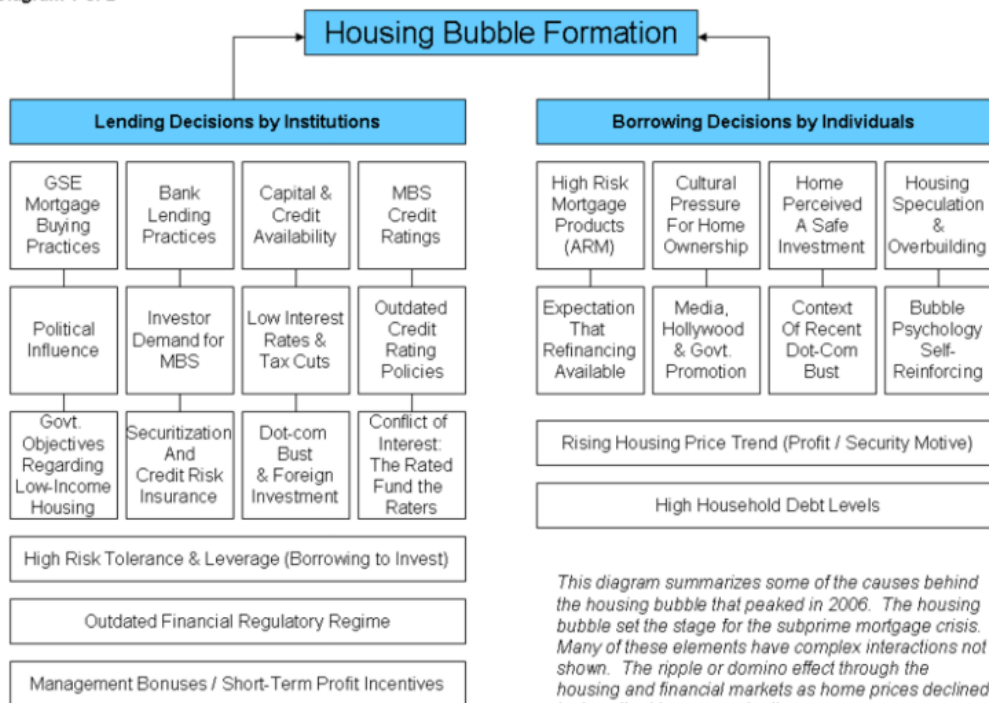
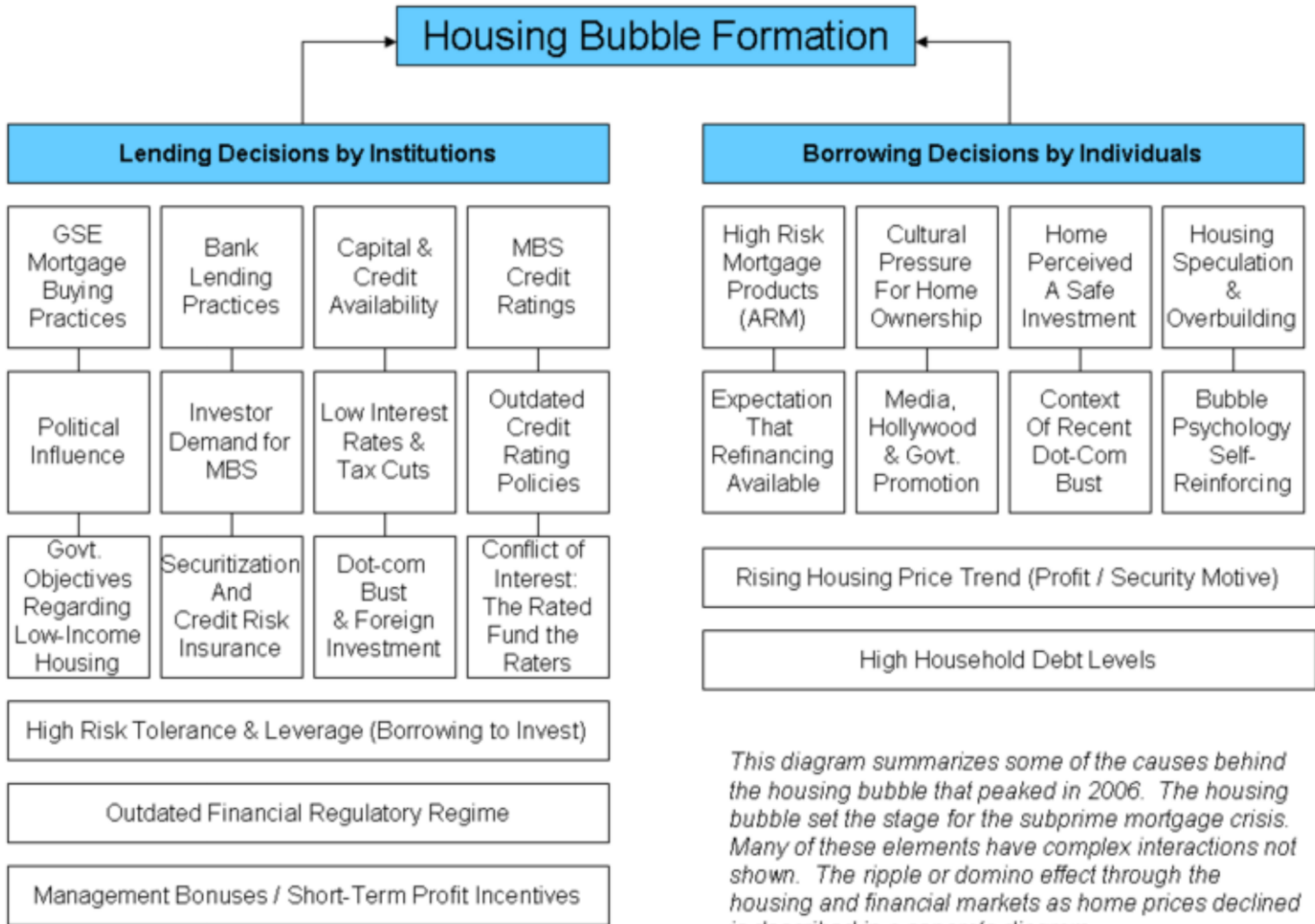


Subprime Mortgage Crisis Harvard Case Solution & Analysis

Subprime Mortgage Crisis
Diagram 1 of 2

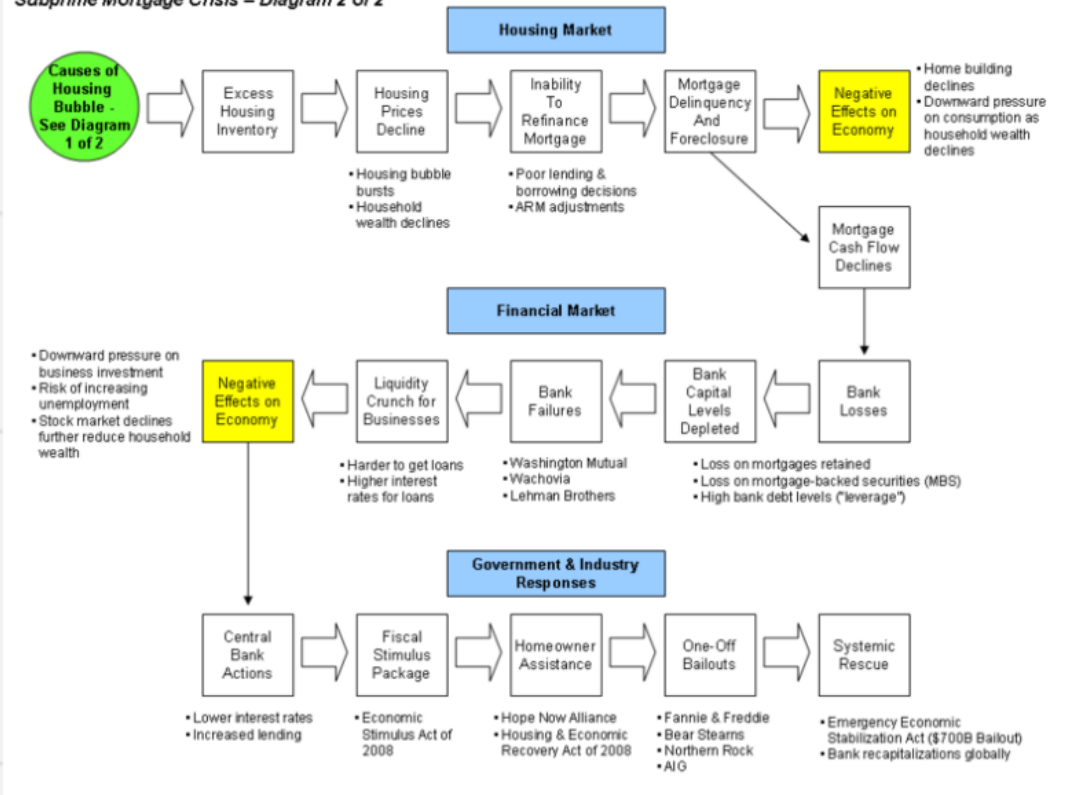




This diagram summarizes some of the causes behind the housing bubble that peaked in 2006. The housing bubble set the stage for the subprime mortgage crisis. Many of these elements have complex interactions not shown. The ripple or domino effect through the housing and financial markets as home prices declined is described in a separate diagram.

Background & Timeline

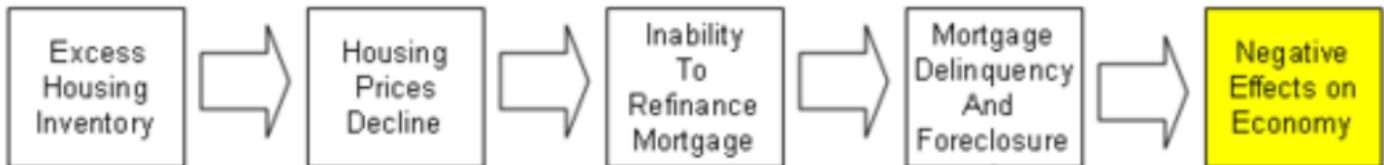
Subprime Mortgage Crisis – Diagram 2 of 2



Subprime Mortgage Crisis – Diagram 2 of 2

Causes of Housing Bubble - See Diagram 1 of 2

Housing Market



- Housing bubble bursts
- Household wealth declines

- Poor lending & borrowing decisions
- ARM adjustments

- Home building declines
- Downward pressure on consumption as household wealth declines

Mortgage Cash Flow Declines

Financial Market



- Harder to get loans
- Higher interest rates for loans

- Washington Mutual
- Wachovia
- Lehman Brothers

- Loss on mortgages retained
- Loss on mortgage-backed securities (MBS)
- High bank debt levels ("leverage")

- Downward pressure on business investment
- Risk of increasing unemployment
- Stock market declines further reduce household wealth

Government & Industry Responses



- Lower interest rates
- Increased lending

- Economic Stimulus Act of 2008

- Hope Now Alliance
- Housing & Economic Recovery Act of 2008

- Fannie & Freddie
- Bear Stearns
- Northern Rock
- AIG

- Emergency Economic Stabilization Act (\$700B Bailout)
- Bank recapitalizations globally

Housing Market

- Housing Bubble was characterized by:
 - Higher sales of household
 - Greater household debt
 - Higher prices
 - Lower savings
- Fueled by:
 - low interest rates
 - large inflows of foreign funds
 - easy credit candidates

Housing Market

- Demand in households caused an increase in price
- Increasing price caused a demand in households
 - People were buying and "flipping" houses
- Subprime lending allowed individuals with low income but decent credit to buy houses well beyond their reach
 - ARM (adjustable rate mortgage)
 - SIVA replaces proof of income
- Increased demand for mortgage, investment banks responded with:
 - MBS
 - Colateralized debt

Housing Market

Subprime Mortgage Crisis: "Vicious Cycles" of Foreclosure and Bank Instability

