Name: ________________________________

***How Credit Crises Happen*, Excerpt 1**

"A home is a type of investment. It is also an asset, which means it has a value for its owner. Someone who is looking to buy a home thinks about the cost of the house, its location and size, and how close it is to work and public transportation. A homeowner also looks for a house whose value will rise, or appreciate. An appreciating asset is something that is worth more tomorrow than it is today. When people invest their money, they hope that their assets will increase in value.

…When the price of an asset drops below what can be explained by normal supply and demand factors, the asset is [called] undervalued. And when the price of an asset rises above what can be explained by normal supply and demand factors, the asset is called overvalued. By 2006, single-family homes [in the United States] were overvalued. In fact, homes in Naples, Florida were overvalued by 102.6 percent. The housing industry created a speculative bubble, which is when asset prices rise unreasonably above what is expected."

***How Credit Crises Happen*, Excerpt 2**

"People use credit to make purchases every day. Adults often make monthly mortgage or car payments. Many students pay for their college education through loans. These are examples of using credit to pay for goods and services. Using credit to make a purchase results in taking on debt. A financial debt means that money is owed…

People borrow money to pay for goods and services that cost more than they have in their bank accounts. According to the U.S. Census Bureau, the average sales price of a new home in the United States in 2008 was $292,600. Since most people do not have more than a quarter of a million dollars in their bank accounts to buy a home, they borrow money on credit. This means that they take out a loan to buy a house and legally agree to pay back the money in successive payments, or installments, called mortgage payments…

A secured loan is a loan that is backed up by collateral. Collateral is a physical asset that can be taken back if the borrower defaults on (cannot pay back) the loan. In the case of the mortgage, the collateral is the house. If a borrower cannot make his or her mortgage payments, the lender can take back the house…

People can use assets for collateral to take out loans. The value of your collateral partly determines how much you can borrow. If you have a home that is worth $250,000, you can borrow more money than if your home is worth $100,000. During the housing bubble, people used their rising house values to take on more credit [loans]. And the [housing] bubble created a credit expansion."[1]

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[1] Barbara Gottfried Hollander, *How Credit Crises Happen* (New York: Rosen Publishing, 2011).