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# Resets Peaking on Subprime Loans

Jumping Payments Raise Foreclosure Projections

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The number of homeowners facing an increase in their subprime adjustable-rate mortgage payments will peak this summer, testing the efforts of lenders and others to keep those people out of foreclosure and stabilize the housing market.

The timing reflects the height of subprime lending in the summers of 2005 and 2006, when many borrowers secured loans scheduled to adjust in two or three years. For many, an adjustment means their interest rate will go up two to three percentage points.

"The next six months, the industry, all of the folks that are out there trying to solve this problem, they are going to be very busy," said Mark Fleming, chief economist for First American CoreLogic, a California research firm. "There are a lot of people facing their resets right now. A good share of them don't have the refinance option."

Nationally, the number of subprime adjustable-rate loans resetting peaked at 7.61 percent of the loans outstanding last month, according to data from CoreLogic. More than 300,000 such loans will adjust this summer. CoreLogic's data covers about 80 percent of the mortgage market.

In Maryland, 7.28 percent of outstanding subprime adjustable-rate loans will reset to a higher payment in August, while Virginia hit its peak, 7.72 percent, last month, according to CoreLogic. In the District, 7.25 percent of subprime adjustable-rate loans reset in June, but the peak does not come until October, when 7.29 percent of the outstanding loans will reset.

Lenders, federal officials and housing counselors have worried that borrowers will not be able to afford the higher payments after the reset and will quickly fall into foreclosure. Declining home prices have made it impossible for many of these homeowners to refinance.

It will not be clear for months how many will lose their homes, Fleming said. "A lot of those are resetting now," he said. "We may not see the impact in foreclosures until the middle of 2009."

Foreclosure rates have set records nationally. The Washington area has one of the fastest-growing foreclosure rates in the nation, according to a recent report by the Metropolitan Washington Council of Governments and Freddie Mac.

"Locally we're going to continue to see foreclosures be at a high level until these resets finish their run," said John McClain, deputy director of the Center for Regional Analysis at George Mason University. If home prices do not continue to drop, the foreclosure rate could start to slow in late fall or early next year, he said.

The mortgage industry has trumpeted efforts to reach homeowners and put them in affordable mortgages. Members of Hope Now, an alliance of mortgage lenders and nonprofit groups, have agreed to contact homeowners 120 days before their loans reset. This summer will test those efforts.

"There has been a lot of work done to meet the demand," said Faith Schwartz, head of Hope Now.

Since January, the alliance has been monitoring 718,000 subprime loans with resets scheduled for this year, looking for trends and problems, Schwartz said. Less than 1 percent of homeowners who paid their mortgage on time before their loans reset have fallen into foreclosure, she said. Others have sold their home or found a way to refinance, she said.

"We're trying to measure the effectiveness of the guidance" the industry adopted to combat the problem, Schwartz said. If the figures demonstrate problems among a subset of borrowers, the industry can react quickly, she said.

The threat of soaring adjustable-rate loans has been tempered by the Federal Reserve's interest-rate cuts over the past year, Schwartz said. A borrower with a typical-size subprime ARM of about $200,000 could expect payments to increase about $70 a month if it reset now, compared with about $450 a month if it had reset in December, according to the American Securitization Forum, a financial industry group.

But analysts and housing counselors have noted that while the interest rate decreases have helped some borrowers, others still face a rate shock because they had an artificially low introductory rate, known as a teaser rate, or other types of loans. Some homeowners face an 8 to 10 percent increase in their payments, said Bruce Marks, executive director of the Neighborhood Assistance Corporation of America.

Resets are "still going to be driving the rate to what people can't afford, to an unaffordable mortgage payment," Marks said.

After reaching its peak this summer, the number of subprime adjustable-rate loans facing resets drops off significantly early next year, according to CoreLogic's figures. By January, only 4.8 percent of subprime loans will face resets, compared with 7.61 percent this month. By May, that will fall to 1.94 percent.

That decline reflects when lenders and borrowers turned away from those loans two years ago, Fleming said. By the end of this year, 75 percent of outstanding subprime adjustable-rate mortgages will have reset, he said.

"In 2005, 2006, we started to shut down those lines of loan products," Fleming said. "They are all coming due now."

Borrowers may face another significant problem when option ARM loans, which allowed them to make less than full payments, face increases, said John Taylor, president of the National Community Reinvestment Coalition. Those are not classified as subprime loans, but the borrowers will begin to see their payments spike in the next few years as they are forced to start paying the principal of their loans as well as the interest, he said.

"There is this second wave behind" subprime loans, Taylor said, "that is going to complete the tsunami."

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