TIME
Inside Business BONUS SECTION
Wednesday, May 10, 2006

# Mortgage Mess

## With interest rates pushing up monthly bills andÃ‚Â housing prices cooling, some worried homeownersÃ‚Â are barely hangingÃ‚Â on. Here's how to cope

By JEREMY CAPLAN

The end may be just the beginning. After 15 hikes in less than two years, the Federal Reserve has signaled that it has probably finished bumping up interest rates, but for people who borrowed heavily to buy new homes during the recent boom, the damage is done. Those hugely popular adjustable-rate mortgages (ARMS) have always had a catch--the low initial rates last only a year or so--and the new terms are now kicking in for the latest wave of ARM holders.

In many cases, they are watching their monthly mortgage bills jump dramatically, from $1,000 a month to $1,200, for instance, for the average-size $150,000 loan. For homeowners struggling to handle those payments while shouldering rising costs for health care, gas and education (not to mention higher rates on their credit-card debt), trouble is almost inevitable.

Home foreclosures in the first quarter of 2006 were up 72% over a year earlier, according to a study by RealtyTrak Inc. of Irvine, Calif. And in such states as Alabama, Michigan and Missouri, a fifth of homeowners in the higher-interest subprime category of ARMS were at least 30 days late in making a mortgage payment at the end of 2005, according to the Mortgage Bankers Association.

If you're one of those people feeling buyer's remorse over what once looked like a great loan deal, there are, unfortunately, few easy options for digging yourself out. The only sure bet is to sell and downsize to a less expensive home or rental. Refinancing into a more stable loan--like a 30-year fixed-rate mortgage--may not lower your payments, but it will give you a steady base for planning a budget and help you avoid a jolt from any further rate hikes. "It's foolish not to take advantage of the opportunity to lock in a reasonable rate given that they could still climb much higher," says Dean Baker, co-director of the Center for Economic and Policy Research.

If your adjustable-rate loan is still new, the higher rates haven't yet taken a bite, but the years ahead may be nerve-racking. According to the National Association of Realtors, the median first-time home buyer's deposit last year was just 2% of the price, while 43% of first-timers put down nothing. That means those real estate newbies will eventually face a sizable chunk of loan principal paired with growing interest payments. If you can't sell before your initial low rates expire, you may want to refinance into a new kind of hybrid loan, such as an adjustable-rate mortgage that eventually converts into a fixed 25-year loan. "You'll moderate the shock of a sudden doubling of your monthly payments," says Christopher Cagan, director of research for First American Real Estate Solutions.

Even if your mortgage is under control, the ripple effects of rising interest

rates could hit your investment portfolio. "Appraisers, mortgage bankers and title-insurance companies are all feeling the brunt of a pretty dramatic slowdown," says Stuart Hoffman, chief economist for PNC Financial Services Group. Hoffman suggests shifting those investing dollars toward stronger parts of the sector, such as the home-renovation and appliance industries. The National Association of Home Builders estimates that homeowners will spend $238 billion on renovations this year, a 13.2% jump from 2005.

The hand wringing over the growing number of homeowners with skyrocketing monthly payments has even drawn the attention of federal regulators, who propose new standards for ARMS and other nontraditional mortgages. But there's no substitute for common sense: never take more mortgage than you can afford.

Copyright © 2006 Time Inc. All rights reserved.
Reproduction in whole or in part without permission is prohibited.

Privacy Policy