

## Refinancing a Home

# Re-refinancing, and Putting Off Mortgage Pain

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It is the latest twist in the gravity-defying world of the high housing prices and exotic low-rate mortgages: As monthly payments on adjustable-rate mortgages are starting to balloon, many Americans have found a way to put off the day of reckoning.

They are refinancing with new adjustable-rate mortgages that keep monthly payments low — for now, that is, though their payments will likely rise even higher in the future.

“Some people would say I am a little crazy,” acknowledged R. Lance Perry, 42, of Danville, Calif., one of the new breed of people refinancing their mortgages. But faced with a sharp increase in his monthly payments and a need to take cash out of his home, he refinanced earlier this year to keep his payments the same.

By the time the rate goes up, he figures, his income will have increased enough to cover the higher payments, he will have refinanced again or he will have moved.

Like Mr. Perry, millions of Americans have turned to adjustable-rate mortgages, or A.R.M.'s, in recent years to afford a home as prices soared.

Typically set at artificially low rates in the first years of the loan, these mortgages are then reset at the prevailing interest rates. For borrowers, the bet was that interest rates would remain low.

Now, the first big wave of the mortgage boom is cresting as more than \$400 billion worth of adjustable-rate mortgages, or about 5 percent of all outstanding mortgage debt, will readjust this year for the first time, according to Loan Performance, a research firm. Next year, another \$1 trillion in loans will readjust.

When that happens, for instance, a typical borrower with a \$200,000 A.R.M. could see his monthly payments increase nearly 25 percent when the A.R.M. adjusts from 4.5 percent to 6.5 percent. In total dollars, that is an increase from \$1,013 a month to \$1,254.

Yet instead of paying more now, many borrowers are refinancing into their second or third adjustable-rate mortgage, loan data indicate and industry experts confirm.

So far, the number of borrowers refinancing this way is relatively small — several hundred thousand in the estimate of the credit ratings firm Fitch Ratings — but mortgage industry officials and analysts expect the numbers will surge next year. In doing so, these borrowers are pushing out any eventual shock of higher payments by another two or three years, if not longer.

“They get another two- or three-year hybrid with a low introductory rate to keep payments down,” said Frank E. Nothaft, a vice president and chief economist at Freddie Mac, the mortgage buyer. “They’re trying to put it off forever, which is O.K. as long as interest rates are low. But when they start to spike, then it’s going to be more problematic.”

For now, this mini-refinancing boom is assuaging fears that rising interest rates and higher monthly payments would drive some borrowers into foreclosure or force them to scale back sharply on other spending. As a result, consumer spending may hold up better than some economists had thought.

But the refinancing also represents a doubling-down on a bet that housing prices will continue to rise on the West and East Coasts and in other hot markets. If the value of the home falls closer to the amount of the loan, that could curb the ability to refinance, and may prompt the homeowner to either invest more in the home or to sell it.

Still, borrowers like Mr. Perry say the loans make sense because in a few years they plan to move to another home, earn more or refinance again, often using the same assumptions they made when they took out their earlier loans.

With his new loan, his third adjustable-rate mortgage, Mr. Perry, a former technology project manager, cashed about \$200,000 out of his home’s equity and is investing it into his four-year-old financial planning business. “I could have sold my house and made my family move,” said Mr. Perry, 42, who lives with his wife and a 3-year-old son in Danville, about 20 miles east of Oakland. “But I didn’t do that. I said, ‘Look, I want to start a new business,’ and this product allowed me to do that.”

He said he was taking on more risk than many of his clients would be willing to because he believes his business will continue to grow. After spending 15 years in the technology industry, which put him on the road constantly, Mr. Perry said that being self-employed allowed him to spend more time with his family, which he also expects to grow. As far as the house, he said: “I am not going to be here for 30 years. Why is it important to have a fixed mortgage?”

That sentiment resonates nationally, and especially in California.

Even as mortgage applications over all are falling because of slowing home sales and rising rates, adjustable-rate mortgages made up about 30 percent of all loans in May, down only slightly from 34.2 percent in May 2005, according to the Mortgage Bankers Association of America. In the San Francisco Bay area, adjustable mortgages of the kind Mr. Perry borrowed make up 49 percent of all refinance loans so far this year, according to Loan Performance.

Though they have been around for decades, the use of adjustable-rate mortgages has soared in the last several years, helping fuel the housing boom by letting people borrow more than they might

have been able to. For buyers who do not intend to stay in their homes for long, they can cost a lot less than 30-year, fixed-rate mortgages.

Adjustable loans come in many forms. Most have low and fixed teaser rates initially. Many, like interest-only or “option” A.R.M.’s, also let borrowers pay only the interest portion of the debt or even less than that. After the introductory period ends, lenders require bigger payments and ratchet up interest rates. And rates have been rising as the Federal Reserve continues a campaign to make credit more expensive.

The national average rate on a five-year adjustable-rate loan was 6.28 percent in June, up from 5.02 percent in early 2005, according to Freddie Mac. The average rate on 30-year fixed loans increased to 6.68 percent from 5.63 percent.

For businesses involved in financing real estate, adjustable loans and the refinancing they generate assure a steady stream of transactions. The beneficiaries include mortgage brokers, appraisers, banks, mortgage companies and Wall Street, where home loans are increasingly bundled and sold as securities.

Industry officials say that adjustable-rate mortgages cater to borrowers’ changing tastes and strategies. With interest rates still near historical lows and lifestyles that are more transient, many borrowers view the standard 30-year, fixed-rate mortgage as an anachronism.

Borrowers no longer “ask me what is the quickest way I can pay off my mortgage,” said Jack Williams, the president of the California Association of Mortgage Brokers and a broker in Orange County. “I haven’t heard people say that for 15 years.”

Many home buyers, however, say they have used adjustable-rate mortgages to manage their finances in the short run with the expectation of going to a fixed-rate loan.

Maribel Chino and her fiancé, Felix Burgos, refinanced the option A.R.M. on their town house in Brooklyn four months ago with a fixed-rate mortgage with a 7 percent rate after seeing the levy on a prior adjustable loan climb past 6 percent from an initial rate of 4.25 percent.

The \$800 increase in the couple’s mortgage payment, now \$3,100 a month, has forced them to budget more carefully, but they believe that the \$8,000 to \$12,000 a year they saved in payments for the first three years they owned their home made the A.R.M. worth it.

“It was good to start with,” Ms. Chino said. Mr. Burgos added: “Now we are paying 20 to 25 percent more, but we are comfortable.”

The ability to refinance with additional adjustable-rate mortgages diminishes when housing values fail to keep up with the rise in the household’s debt. So far, use of A.R.M.’s tends to be concentrated on the East and West Coasts, where housing markets have remained relatively robust. And even as interest rates rise, consumer default and delinquency rates have remained low.

“Before you see a distress sign, you have to have distress,” said Susan M. Wachter, a professor of real estate and finance at the Wharton School of the University of Pennsylvania. “And the distress will be higher unemployment and declining home values.” (*Florida have the lowest unemployment rate in the USA – Note from CondHotel*).

Stress, however, is starting to build in some regions and among certain borrowers.

Midwestern states have seen a rise in foreclosures and defaults because of job losses in automobile and other manufacturing industries. In the South, the aftermath of last year’s hurricanes is still rippling through family finances.

Yet these regions do not have as heavy a concentration of adjustable loans as the East and West Coasts do, which suggests that an economic downturn may be far more devastating in coastal markets.

California, which has 14 percent of the country’s housing stock, leads the nation with 21 percent of homes purchased with adjustable-rate mortgages, and 44 percent of California borrowers have refinanced with option-A.R.M. loans so far this year, according to Loan Performance. Other markets where those loans are popular include Arizona, Nevada, Florida, Virginia, and Washington, D.C.

Another group that draws concern are borrowers with subprime credit, a group that has been a growth market for many mortgage companies.

About 6.28 percent of all outstanding subprime, adjustable mortgages were in foreclosure or delinquent for more than three months during the first three months of this year, up from 5.23 percent in the same period a year ago, according to the Mortgage Bankers Association.

While those numbers are still lower than they were at the start of the decade, economists say there is reason for concern. An analysis by Fannie Mae, the mortgage buyer, of subprime adjustable loans issued from March 2003 to March 2004 that have adjusted showed that 16 percent of subprime borrowers have defaulted or are late in making monthly payments; another 14 percent have not yet refinanced. About 70 percent have refinanced.

The fate of subprime borrowers, industry experts and economists say, will be closely tied to home values and the job market. If they make more money and the value of their homes continues to appreciate, they will be able to refinance and make higher monthly payments.

If home prices fall or stagnate, homeowners will have less collateral against which they can borrow, said Grant Bailey, a director in Fitch Ratings’ residential mortgage-backed securities group.

“They kick the can out two years,” he said, “and everything works fine as long as there is pretty decent home price appreciation.”