03/17/2007

Homeowners and Home Buyers: Prepare For Sub-Prime Fallout

If you have been paying attention to the news lately, you have probably heard a lot about the suffering sub-prime mortgage market. More and more of these “bad credit” borrowers are defaulting on their home loans, and those rising foreclosures are translating into general fears about the economy, which are causing a falling stock market. So what is this mortgage mayhem all about and what does it mean for you as a homeowner or a potential home buyer?

The Problems

The problems really started several years ago during the recent housing boom. Home prices in many areas were appreciating like crazy and houses were selling in a matter of days, or even hours, of being listed. For those with poor credit, getting into a normal housing market can be tough enough, but with skyrocketing prices, many simply didn’t have the income and credit requirements to qualify for financing.

The sub-prime mortgage market is made up of lenders who specialize in loaning money to bad credit buyers. Although they will charge higher interest rates, points, and other fees, they have looser underwriting standards that allow these borrowers a chance into the home-owning scene.

Most of the programs sub-prime lenders employ are variations of adjustable rate mortgages (ARMs), meaning the interest rate can change from time to time. Popular options include hybrid ARMs with fixed rate periods for an initial one to ten years, as well as interest-only and pay-option ARMs. Interest-only loans allow borrowers to pay only the amount of interest due each month for a set period after which they have to start paying both interest and principal. Pay-option ARMs give borrowers four different payment options each month for a while, with the lowest being less than even the amount of the interest due.

As interest rates have started to reset on many of the sub-prime loans issued a few years ago, many bad credit buyers are finding that their home values have stagnated due to the current housing slump. They are unable to refinance into lower payment loans and they cannot afford the new higher payments on their present loans. The result is that many sub-prime borrowers are going into foreclosure. In fact one recent study forecasted that of all the sub-prime mortgages created in 2005-2006, one in five will go into default, with a majority of those presenting themselves this year.

The Implications

If you are considering buying a home this year and you have good credit, you will probably be in a good position. With the increasing number of foreclosures there will be even more houses on an already over-crowded market, giving you more bargaining power than ever.

If you have poor credit though, things may be a little rough. Even sub-prime lenders are starting to tighten their standards. It may be tougher to find financing this year as more and more sub-prime lenders bow out of the industry. Already this year, 25 sub-prime companies have closed up and many others lenders are drastically scaling back their bad credit divisions. If you have bad credit, 2007 may be the year to keep renting and try to improve your credit

Copyright © 1999-2008 Homeloanbasics.com, Etrafficers, Inc., or its affiliates

score by making all your payments time and reducing your debt.

If you are a homeowner, what all of this sub-prime mortgage muddle means is that it may be a harder year to sell your home than you may have thought. There will be fewer buyers and many more homes on the market competing for business.

If you are trying to refinance, you will probably be fine, unless you still have bad credit. With bad credit, you will run into the same problem of having fewer lenders to turn to with fewer resources to offer you. You may also need to follow the suggestions to wait out this year in your current loan while doing everything you can to improve your credit score for a future mortgage.

Copyright © 1999-2008 Homeloanbasics.com, Etrafficers, Inc., or its affiliates