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Suprime Loan Trouble? Try Another Subprime Loan

If you got into a home during the last several years using a subprime or “bad credit” mortgage, you may now be finding yourself in a tough spot as your interest rate resets and your monthly payments increase. And you are not alone in your troubles. Some market analysts estimate that as much s $1.5 trillion worth of adjustable rate mortgages (ARMs) are on track to have resetting interest rates this year.

Many of those subprime borrowers who have already seen their rates adjust have been unable to cope with the payment shock. The number of defaults among subprime borrowers rose to 10.09% in November 2006, up from 9.08% in October, and up significantly from 5.37% in May 2005. A recent study from the Center for Responsible Lending (CRL) found that almost one in five subprime loans created in the past two years is at high risk for failure.

So if you find yourself among these at-risk subprime borrowers, what can you do to avoid foreclosure? Some industry experts suggest trying to refinance into another subprime loan. While these loans carry high interest rates and fees, they are generally adjustable rate mortgages that provide for very low initial payments. One of the most popular subprime loans is the “2-28” that carries a low interest rate and payment for the first two years. The rate rises thereafter but if borrowers use that two years to make timely payments and restore or improve their credit scores, they can generally qualify for prime refinance mortgages with better terms. So getting a new subprime loan will not solve your problems in the long run, but it may buy you some time to figure out your next mortgage move while allowing you to avoid foreclosure.

Based on his own polls of mortgage lenders, Doug Duncan, chief economist for the Mortgage Bankers Association, says that about half of subprime borrowers will be able to refinance into prime mortgages after rebuilding their credit. He worries that new, tighter lending standards may force lenders to stop creating loans like the “2-28.”
“If you eliminate these products -- one of the tools that they use to manage the transition (out of subprime) -- then you reduce the probability of them making the transition,” Duncan said.
Yet there are still risks involved in getting anew subprime loan. Debbie Goldstein, CRL vice president, warns that getting refinanced a subprime mortgage "is going to do more damage and prolong the inevitable -- which is foreclosure for most people." She says that according to the CRL’s own studies, not 50%, but only 25% of subprime borrowers take the necessary steps to be able to qualify for prime refinance terms.
The bottom line is whether or not getting a new subprime loan will save you from foreclosure, a veritable death sentence in the mortgage world. If it will prevent disaster in the short-term, it may be worth doing, extra expenses and all, if you are committed to improving your credit and getting into a better loan. If you truly cannot afford the home you are in, no matter the loan terms, it may be time to cut your losses and sell before you go into foreclosure.