

# "Option" mortgages to explode, officials warn

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By [Lisa Lambert](#)

WASHINGTON (Reuters) - The federal government and states are girding themselves for the next foreclosure crisis in the country's housing downturn: payment option adjustable rate mortgages that are beginning to reset.

"Payment option ARMs are about to explode," Iowa Attorney General Tom Miller said after a Thursday meeting with members of President [Barack Obama's](#) administration to discuss ways to combat mortgage scams.

"That's the next round of potential foreclosures in our country," he said.

Option-ARMs are now considered among the riskiest offered during the recent housing boom and have left many borrowers owing more than their homes are worth. These "underwater" mortgages have been a driving force behind rising defaults and mounting foreclosures.

In Arizona, 128,000 of those mortgages will reset over the the next year and many have started to adjust this month, the state's attorney general, Terry Goddard, told Reuters after the meeting.

"It's the other shoe," he said. "I can't say it's waiting to drop. It's dropping now."

The mortgages differ from other ARMs by offering an option to pay only the interest each month or a low minimum payment that leads to a rising balance in the loan's principal.

When the balance of the loan reaches a certain level or the mortgage hits a specific date, the borrower must begin making full payments to cover the new amount. The loan's interest rate also may have been fixed at a low level for the first few years with a so-called teaser rate, but then reset to a higher level.

Because the new monthly payments can be five or 10 times what borrowers are accustomed to paying, they "threaten a much greater hit to the consumer than the subprimes," Goddard said, referring to the mortgages often extended to less credit-worthy

borrowers that fed the first wave of the financial crisis.

Miller said option-ARMs were discussed at Tuesday's meeting on mortgage scams, which brought state attorneys general from across the country together with U.S. Treasury Secretary [Timothy Geithner](#), Attorney General Eric Holder, Housing and Urban Development Secretary Shaun Donovan, and Federal Trade Commission Chairman Jon Leibowitz.

The mortgages tend to be "jumbo," or for significantly large amounts, Goddard said, making it even harder for borrowers to sidestep foreclosure. He said he expected to see an increase in scams as distressed homeowners become more desperate to refinance big debts.

Goddard said his office is investigating hundreds of cases where companies have made fraudulent promises, and charged large fees, to mortgage defaulters.

The U.S. housing market has suffered the worst downturn since the Great Depression, and its impact has rippled through the recession-hit economy.

Some signs of stabilization emerged recently, with sales rising and home price declines moderating in many regions of the country. Home prices in some regions have risen.

However, many economists say there is still a huge supply of unsold homes lingering on the market and that, coupled with a frenzy of more foreclosures ahead, should depress home prices for the rest of 2009.

Real estate data firm RealtyTrac, in its August 2009 U.S. Foreclosure Market Report, said foreclosure filings -- default notices, scheduled auctions and bank repossessions -- were reported on 358,471 U.S. properties during the month, a decrease of less than 1 percent from the previous month, but an increase of nearly 18 percent from the same month a year ago.

The report said one in every 357 U.S. housing units received a foreclosure filing last month.

(Additional Reporting by Julie Haviv; Editing by Padraic Cassidy)

<http://www.reuters.com/article/ousivMolt/idUSTRE58G5U320090917?sp=true>