Predatory Lending: Don't Let a Bad Loan Trap You!

The Massachusetts Commission Against Discrimination (MCAD) is the state's chief civil rights agency. The Commission works to eliminate discrimination on a variety of bases and in a variety of areas, and strives to advance the civil rights of the people of the Commonwealth through law enforcement, outreach and training.

Massachusetts civil rights law protects individuals from discrimination in employment, housing, public accommodations, mortgage lending, credit, and education. Each of these areas offers protections to particular groups.

Massachusetts General Law Chapter 151B, Section 4, **Paragraph** 3B states that it shall be unlawful:

For any person whose business includes granting mortgage loans or engaging in residential real estate-related transactions to discriminate against any person in the granting of any mortgage loan or in making available such a transaction, or in the terms or conditions of such a loan or transaction, because of race, color, religion, sex, sexual orientation which shall not include persons whose sexual orientation involves minor children as the sex object, children, national origin, genetic information, ancestry, age or handicap. Such transactions shall include, but not be limited to:

(1) the making or purchasing of loans or the provision of other financial assistance for purchasing, constructing, improving, repairing, or maintaining a dwelling; or the making or purchasing of loans or the provision of other financial assistance secured by residential real estate; or

(2) the selling, brokering, or appraising of residential real estate.

In the case of age, the following shall not be an unlawful practice:

(1) an inquiry of age for the purpose of determining a pertinent element of credit worthiness;

(2) the use of an empirically derived credit system which considers age; provided, however, that such system is based on demonstrably and statistically sound data; and provided, further, that such system does not assign a negative factor or score to any applicant who has reached age sixty-two;

(3) the offering of credit life insurance or credit disability insurance, in conjunction with any mortgage loan, to a limited age group;

(4) the failure or refusal to grant any mortgage loan to a person who has not attained the age of majority;

(5) the failure or refusal to grant any mortgage loan the duration of which exceeds the life expectancy of the applicant as determined by the most recent Individual Annuity Mortality Table.

Nothing in this subsection prohibits a person engaged in the business of furnishing appraisals of real property from taking into consideration factors other than those hereinabove proscribed.

Some useful websites are:

http://www.mass.gov/mcad/

www.HUD.gov

http://www.hud.gov/local/ma/homeownership/predatorylending.cfm

www.responsiblelending.org

www.fanniemae.com

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Definitions

Adjustable Rate Mortgages: Loans that allow for the interest rate to go up or down depending on economic conditions. These loans start at a lower interest rate, but can often go up after a year. These enable borrowers who expect their income to increase to get loans they may not otherwise afford.

APR: Annual Percentage Rate.

Bait and Switch: The consumer is offered a desirable product, and then switched to a less desirable product, usually at a higher cost or additional fees.

Balloon Loans: Loans that require a large final or "balloon" payment that can add up to nearly the total loan amount. Lenders say balloon loans allow borrowers to get loans at lower monthly costs than they would otherwise be able to. This is especially appealing to borrowers who expect their income to increase or to be able to refinance a loan within a few years.

Broker's Fee: The fee a broker charges to help borrowers get a loan. In many subprime loans, the fee is 10 percent of the loan.

Credit Insurance: An insurance policy often sold to subprime borrowers and financed in the loan. The insurance is used if the borrower dies, becomes disabled or unemployed. Brokers often push credit insurance because it includes a large commission for them since some lending companies are affiliated with insurance companies.

FHA: Federal Housing Administration.

Loan Flipping: Lenders make loans that refinance existing loans in an effort to pocket more fees.

Mortgage Broker: An independent real estate financing professional who specializes in generating home or commercial mortgages.

Points: A fee that can be charged as part of the loan. Each point is equal to 1 percent of the loan amount. Conventional borrowers can pay points to help lower the interest rate.

Prepayment Penalties: Fees that are charged if a loan is paid off more quickly than planned.

Redlining: The practice of denying an extension of credit to people living in specific geographic areas due to the race of its residents.

Reverse Redlining: The practice of extending credit on unfair terms to those same communities.

Subprime Loans: Loans usually made to low- and middle-income people with a less than perfect credit history. The increased credit risk results in a higher interest rate than those paid by borrowers with a better credit history.

Introduction

It doesn't matter who you talk to – bankers, lawyers or politicians – it is difficult for them to give an exact answer to the following question: What is predatory lending? The reason there is no specific answer is simple: abusive lending practices which may be characterized as "predatory" are more easily described by their features than by a specific, legal definition.

One feature seems to be the groups who fall victim to predatory lending – the elderly, minorities, and individuals with lower incomes and less education. In many instances, these individuals do not have the experience with or knowledge about complex financial transactions to understand the potentially devastating implications. Other times, these groups simply are not offered the range of financial products available to other borrowers. The ultimate risk to anyone who falls prey to predatory lending is no longer just bankruptcy; it could be the loss of his or her home. Most banks and lending institutions do not participate in predatory lending. However, some do. And that is why you must be aware of the signs to avoid predatory lending.

Don't let a bad loan trap you!

Subprime vs. Predatory Lending

The reason for charging one loan customer a higher cost (fees and interest) for a home loan than another customer is to compensate for the different levels of risk, based upon the borrowers' credit profiles. High interest, high-fee mortgage loans are referred to as subprime mortgages. The lenders who specialize in this niche market are called subprime lenders.

Subprime loans **may or may not** be predatory loans. It depends on their terms and on how and why they are offered to particular borrowers. Loans become predatory when they are based on race, ethnicity or other protected class status and are violations of state law.

Proving predatory lending requires examining borrower loan documents and conducting interviews to determine if there has been a violation of consumer laws.

In theory, a predatory loan is any loan where the borrower's expenses cannot be justified on the basis of the lender's risk and cost.

Understanding Predatory Lending

Predatory lending may take many forms. It involves loan practices that force difficult, and possibly false, terms and conditions on the borrower. These terms and conditions may be designed to strip equity from the mortgaged property and/or seize the equity-rich property through foreclosure, with little or no financial benefit to you – the borrower.

Predatory lending is defined based on three main parts: 1) the terms of the loan, 2) the needs and capabilities of the borrower and 3) the intent, impact or effects of the lender's actions. Predatory lending practices based on race, ethnicity or other protected class status violate state law.

Terms of the Loan

In making a loan, a lender must review the ability of the borrower to repay the loan based on the borrower's income and debts. A lender who fails to conduct such a basic review is lending without regard to the borrower's ability to repay the loan.

This process begins with a loan that is based on equity in a property rather than on a borrower's ability to repay the loan. This is known as *asset-based lending*. The rule of thumb in this situation is that loans made to people who do not have the income to repay the loans usually are designed to fail. They frequently result in the lender acquiring the borrower's home equity. The borrower is likely to default and then lose the home through foreclosure or by signing over the deed to the lender instead of foreclosure.

The Needs and Capabilities of the Borrower

Loan flipping is the "practice of repeatedly refinancing a mortgage loan without benefit to the borrower in order to profit from high origination fees, closing costs, points, prepayment penalties and other charges." This eliminates the borrower's equity in their home. The loan may also be written in such a way to make sure that it will be refinanced in a short time period. While the borrower may receive a modest decrease in the interest rate of the loan with a slightly smaller payment, the additional points and fees make the total transaction more costly to the borrower than the original loan.

The Intent, Effect and Impact of the Lenders Actions

A third abusive practice is simply outright fraud, which takes advantage of a borrower's lack of understanding and inexperience. Such practices involve a wide range of cases often involving home improvement scams, the falsification of information on loan documents, failure to disclose information regarding the terms of the loan, obstructing customers from refinancing with other companies to gain better terms and high pressure sales tactics.

Examples of Predatory Lending

Incidents of predatory lending have been on the rise in recent years. Numerous government and private housing groups have held public hearings and meetings within various communities to hear their stories. The media has done numerous features on the victims and their heart-breaking stories. Here are just a few of them.

"Alice"

Alice was 71 years old. She received a phone call from a mortgage broker, who promised her that he would refinance her two existing mortgages, provide her with $5,000 in extra cash and lower her monthly payments.

Alice needed cash to repair her kitchen, so she agreed to meet. The broker visited Alice at her home. Alice recalls that she began to trust the man because he claimed he liked her as a person and he wanted to help senior citizens because his own father had recently died of cancer. A few days later, the broker came back to Alice's house to have her sign the mortgage loan papers. Alice said she told the broker she could not read the documents carefully because she suffers from vision problems and has a limited education. At the broker's promises and encouragement that the mortgage loan would provide her with cash to repair her kitchen and lower her monthly mortgage payments, Alice signed the papers.

Trapped?

Alice received a $90,100 mortgage with an APR of 14.819%. The mortgage loan contained a 15-year balloon note that required a final payment of $79,722.61 – due when she was 86 years old. Alice paid 10% of the loan amount or $9,100 as a broker's fee. The monthly payment increased to approximately 80% of her monthly income. Alice never received the money to complete the necessary repairs on her kitchen.

Alice experienced:

- Use of *bait and switch* tactics to defraud the borrower.
- Use of balloon payments that require refinancing.
- Structuring loans that the borrower cannot afford.
- A broker who took advantage of an older minority, two of the most frequently victimized groups of predatory lenders.
- Aggressive solicitation of residents of low-income and minority neighborhoods, which may be underserved by conventional lenders.
- Excessive fees.

"Florence"

Florence was a 53-year old Haitian-American woman. She had a leaky roof and needed some other home repairs. A home improvement contractor came to her home and offered to do some home repairs. While they talked about the work to be done, Florence said that the contractor pressured her into contracting for additional home repairs that did not need to be done as a condition to getting a loan. The contractor told Florence that he could get her a loan to complete the home repairs even though she had to pay off some other debts. The home improvement contract totaled $36,300.

Through the home improvement contractor, Florence obtained the mortgage loan from the lender for $79,000. Her monthly payments were close to $970. She said she did not receive any closing documents until she contacted the lender more than a week after closing to ask for the amount of her monthly payment.

The lender received 10 points, or $7,900, as well as a $695 application fee. The mortgage loan's interest rate is fixed at 14½% with an APR of 16.498%, along with a balloon payment of $71,812.64 due 15 years after the origination date. The mortgage loan also includes a prepayment penalty if paid off during the first 12 months.

Florence's loan qualifies as a HOEPA (Home Owners and Equity Protection Act) loan, but she never received any HOEPA disclosures. The loan was sold to another lender.

Florence said the contractor began gutting her house about one month prior to the loan closing and the three-day rescission period ended. Because of this, Florence said she felt that she had no choice but to sign the mortgage loan documents in order to pay for the repairs. About a month after the loan closing, the contractor stopped coming to her house and the work was not completed as promised.

What work was completed was not done well. Florence called the lender to find out why the contractor stopped working on the repairs. The company said the contractor had been paid in full. Florence did not remember signing a check or any other document to verify that she approved payment to the contractor.

Florence experienced:

- Dishonest home improvement contractors who use an aggressive sales pitch, require unnecessary services to obtain loans and work with corrupt lenders.
- Prevalence of fraud by home improvement contractors who frequently perform substandard work or fail to complete tasks after being paid in full from the loan proceeds.
- High fees charged by some lenders who provide little or no actual service to the borrower.
- Failure of unscrupulous lenders to comply with existing laws designed to protect subprime borrowers entering into high cost loans increased to approximately 80% of her monthly income.

Trapped?

"Clarice"

Clarice is 81 years old. She is an African-American homeowner and a widow. She was encouraged by a mortgage broker to refinance an existing $118,000 mortgage loan into a new loan for $129,000.

Trapped?

Clarice said the broker persuaded her to take the new loan by claiming it would retire existing unsecured debt, lower her monthly payments, cover her real estate taxes and insurance, and lower her interest rate.

None of these claims was true. In fact, Clarice's new loan did not pay off any unsecured debt, raised her monthly payments, did not cover her tax and insurance obligations, and, after a two year period, will significantly increase her interest rate. The new loan provided Clarice with no benefits at all. Not only were no unsecured debts paid off, she received no cash from the loan. The mortgage broker made $3,850 as a result of the transaction.

The same mortgage broker did Clarice's prior mortgage loan, which was taken out two years ago. That loan contained a substantial pre-payment penalty if paid off in less than three years. Clarice paid a large pre-payment penalty, in addition to her closing costs, on the second loan. The mortgage broker's combined compensation on the two loans exceeded $12,000.

Clarice experienced:

- Tendency of predatory lenders to engage in *loan flipping* – successively refinancing loans with little or no benefit to borrowers, but making substantial fees for brokers.
- Repeated refinancing of points and fees charged with each loan can reduce the equity in a home.
- Inclusion of pre-payment penalties in predatory loans to discourage refinancing at a lower rate or have language in the loan to generate additional fees if refinancing would occur.

"David"

David purchased a home from a private property owner. David said the owner suggested that he apply for an FHA mortgage to cover the $115,000 sales price and the closing costs. The property owner referred David to a lender, who shared a close business relationship with him. The lender arranged FHA financing for the purchase price and all settlement charges, including the lender's origination costs.

Trapped?

The property was grossly over-appraised. Actual comparable properties in the area were appraised in the $75-85,000 range. David stated he later learned that the property owner had purchased the property less than a year earlier for $32,000. The property owner then made cosmetic improvements to the house and put it up for sale for $115,000. As a result of the transaction, David now owes a mortgage of $115,000 for a property that is worth a lot less than the purchase price. Should he be unable for any reason to make the payments, the lender will make a claim against the FHA for the amount of the inflated mortgage.

David experienced:

- *Asset flipping* — the practice of purchasing a home and then reselling it at a dramatically higher price to an unsuspecting borrower.
- The role that appraisers can play in originating predatory loans by generating fraudulent appraisals that prompt borrowers to take out loans that are larger than necessary to purchase the property at a fair value.

These case examples illustrate only a few ways people have been taken advantage of by less than reputable lenders. Unfortunately, there are many others. As people begin to understand and recognize the “old” predatory lending examples, dishonest lenders may begin to develop new methods of predatory lending.

A list of warning signs that have been involved in other cases of predatory lending has been included on the next page. At each stage in the lending process, keep these in mind as you move through the process of obtaining your financing. There is a lot at stake.

Potential Warning Signs of Predatory Lending

During the Marketing Process

- Aggressive solicitations to targeted neighborhoods
- Home improvement scams
- Kickbacks to mortgage brokers
- Steering to high-rate lenders

- Targeting first-time home buyers (such as Habitat for Humanity buyers)

During the Sales Process

- Purposely structuring loans with payments the borrower cannot afford
- Falsifying loan applications (particularly regarding income level)
- Adding co-signers
- Making loans to mentally incapacitated homeowners
- Forging signatures on loan documents (such as required disclosures)
- Paying off lower income mortgages
- Shifting unsecured debt into mortgages
- Loans in excess of 100% LTV (Loan-to-Value)

Conditions of the Loan Itself

- High annual interest rates
- High points or padded closing costs
- Balloon payments
- Negative amortization
- Inflated appraisal costs
- Padded recording fees
- Bogus broker fees
- Unbundling (itemizing duplicative services and charging separately for them)
- Required credit insurance
- Falsely identifying loans as lines of credit or open-end mortgages
- Force-placed homeowners insurance
- Mandatory arbitration clauses
- Single premium life insurance policies

- If the mortgage is insured by the FHA, predatory lenders who collaborate with asset flippers to structure loans that the consumers cannot afford can benefit by collecting on the FHA insurance after foreclosure.

After the Closing Process

- Flipping (repeated refinancing, often after high-pressure sales)
- Daily interest when loan payments are late
- Abusive collection practices
- Excessive prepayment penalties
- Foreclosure abuses

Who Can I Turn to for Help?

If you believe that you have been the victim of predatory lending, you may discuss your concerns with a Commission staff member who will answer your questions and help you decide whether you should file a complaint with the Commission.
The Commission is available to help you draft the wording of the complaint and prepare it in legal form for your verified signature. Before you sign the complaint, make sure that it is an accurate account of what happened to you, to the best your knowledge and belief.

If federal law also covers your complaint, Commission staff will dual-file your complaint for you with the appropriate federal agency, if you wish. MCAD is a state agency. There is no charge for these services.

You must file your complaint with the MCAD within 300 **days of the alleged act of discrimination, or within 365 days** with a federal agency such as Housing and Urban Development (HUD). You have the right to be represented before the Commission by a private attorney, if you so desire, but you may proceed without an attorney.

Information for this booklet was obtained with authorization from the PA Human Relations Commission and from state law.

For additional copies of this pamphlet, contact us at:

MCAD

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