

Important Home Mortgage Market Facts

- In 2002, foreclosure rates in the U.S. hit their highest level in 30 years.¹
- Freddie Mac estimates that 10-30% of borrowers who obtain loans from the subprime market could have qualified for a conventional loan through Freddie's underwriting system.² Fannie Mae estimates that half of all subprime borrowers could qualify for lower cost conventional financing.³ Fifty subprime lenders in a 1996 poll also estimated that half of their borrowers could have qualified for prime loans.⁴
- Racial disparities in lending actually increase with increased borrower income.⁵
- 17.42% of refinance loans made to white borrowers in 2000 were subprime.
- 49.28% of refinance loans made to African-American borrowers in 2000 were subprime; the rate was 30.33% for Latinos/Hispanics, and 27.94% for Native Americans.⁶
- U.S. borrowers lose \$9.1 billion annually to predatory lending practices.⁷
- Financed Credit Insurance alone costs borrowers \$2.1 billion annually.⁸
- Prepayment penalties alone cost borrowers \$2.3 billion annually.⁹

¹ Mortgage Bankers' Association of America, 2002, mbaa.org.

² *We Open Doors for America's Families*, Freddie Mac's Annual Housing Report for 1997.

³ James H. Carr and Jenny Schuetz, *Financial Services in Distressed Communities: Framing the Issue, Finding Solutions*, Fannie Mae Foundation, August 2001, p. 37, available at <http://www.knowledgeplex.org/kp/report/report/refiles/FinancialServices.pdf>

⁴ "Half of Subprime Loans Categorized as A Qualify, Inside B&C Lending, (June 10, 1996).

⁵ *Risk or Race? Racial Disparities and the Subprime Refinance Market*, Center for Community Change (May, 2002), p.3.

⁶ *Id.*

⁷ Eric Stein, *Quantifying the Economic Cost of Predatory Lending*, *Coalition for Responsible Lending* (July 25, 2001, revised Oct. 30, 2001)

⁸ *Id.* at 6-7.

⁹ *Id.* at 7-8.

Predatory Mortgage Lending Abuses

This list was developed by Bill Brennan of Atlanta Legal Aid and is taken from his testimony to the Senate Special Committee on Aging.¹

I. ORIGINATION OF LOAN

1. Solicitations. Predatory mortgage lenders engage in extensive marketing in targeted neighborhoods. They advertise through television commercials, direct mail, signs in neighborhoods, telephone solicitations, door-to-door solicitations, and flyers stuffed in mailboxes. Many of these companies deceptively tailor their solicitations to resemble social security or other U.S. government checks to prompt homeowners to open the envelopes and otherwise deceive them regarding their predatory intentions.

2. Home Improvement Scams. Predatory mortgage lenders use local home improvement companies essentially as mortgage brokers to solicit business. These companies solicit homeowners for home improvement work. The company may originate a mortgage loan to finance the home improvements and then sell the mortgage to a predatory mortgage lender, or steer the homeowner directly to the predatory lender for financing of the home improvements. The home improvements are often grossly overpriced, and the work is shoddy and incomplete. In some cases, the contractor begins the work before the three-day cool off period has expired. In many cases, the contractor fails to obtain required permits, thereby making sure the work is not inspected for compliance with local codes.

3. Mortgage Brokers -- Kickbacks. Predatory mortgage lenders also originate loans through local mortgage brokers who act as finders for the lenders. Many predatory mortgage lenders have downsized their operations by closing their retail outlets and shifting the origination of loans to these brokers. These brokers represent to the homeowners that they are working for the homeowners to help them obtain the best available mortgage loan. The homeowner usually pays the broker a fee. In fact, the brokers are working for predatory mortgage lenders and being paid kickbacks by lenders for referring the borrowers to the lenders. On loan closing documents, the industry employs euphemisms to describe these referral fees: yield spread premiums and service release fees. Also, unbeknownst to the borrower, his interest is raised to cover the fee. Within the industry, this is called bonus upselling or par-plus premium pricing.

4. Steering to High Rate Lenders. Some banks and mortgage companies steer customers to high rate lenders, including those customers who have good credit and would be eligible for a conventional loan from that bank or lender. In some cases, the customer is turned away before completing a loan application. In other cases, the loan application is wrongfully denied and the customer is referred to a high rate lender. The high rate lender is often an affiliate of the bank or mortgage company, and kickbacks or referral fees are paid as an incentive to steer the customer to the lender.

5. Lending to People Who Cannot Afford the Loans. Some predatory mortgage lenders purposely structure the loans with monthly payments which they know the homeowner cannot afford with the idea that when the homeowner reaches the point of default, they will return to the lender to refinance which provides the lender additional points and fees. Other predatory mortgage lenders, whom we call hard lenders, purposely structure the loans with payments the homeowners cannot afford in order to trigger a foreclosure so that they may acquire the house and the valuable equity in the house at the foreclosure sale.

6. Falsified Loan Applications, Unverified Income. In some cases, lenders knowingly make loans to homeowners who do not have sufficient income to repay the loan. Often, such lenders wish to sell the loan to an investor. To sell the loan, the lender must make the loan package have the appearance to the investor that the borrower has sufficient income. The lender has the borrower sign a blank loan application form. The lender then inserts false information on the form (for example, a job the borrower does not have), making the borrower appear to have higher income than he or she actually has.

7. Adding Co-signers. This is done to create the false impression that together both borrowers have sufficient income to be able to pay off the loan, even though the lender is well aware that the co-signer has no intention of contributing to the repayment of the mortgage. Often, the lender requires the homeowner to

¹ List is posted on website of California Reinvestment Committee, *available at* <http://www.calreinvest.org/campaigns/abuses.html>

transfer half ownership of the house to the co-signer. The homeowner has lost half the ownership of the home and is saddled with a loan she cannot afford to pay.

8. Incapacitated Homeowners. Some predatory lenders make loans to homeowners who are clearly mentally incapacitated. They take advantage of the fact that the homeowner does not understand the nature of the transaction or the papers that she signs. Because of her incapacity, the homeowner does not understand she has a mortgage loan, does not make the payments, and is subject to foreclosure and subsequent eviction.

9. Forgeries. Some predatory lenders forge loan documents. In an ABC Prime Time Live news segment that aired on April 23, 1997, a former employee of a high cost mortgage lender reported that each of the lenders branch offices had a "designated forger" whose job it was to forge documents. In such cases, the unwary homeowners are saddled with loans they know nothing about.

10. High Annual Interest Rates. The very purpose of engaging in predatory mortgage lending is to reap the benefit of high profits. Accordingly, these lenders always charge unconscionably high interest rates, even though their risk is minimal or non-existent. Such rates drastically increase the cost of borrowing for homeowners. Predatory mortgage lenders routinely charge Atlanta area borrowers rates ranging from 12% to 18%, while other lenders charge rates of 7.0% to 7.5%.

11. High Points. Legitimate lenders charge points to borrowers who wish to buy down the interest rate on the loan. Predatory lenders charge high points but there is no corresponding reduction in the interest rate. These points are imposed through prepaid finance charges (or points or origination fees), they are usually 5 to 10% of the loan and may be as much as 20% of the loan. The borrower does not pay these points with cash at closing. Rather, the points are always financed as part of the loan. This increases the amount borrowed, which produces more annual interest to the lender.

12. Balloon payments. Predatory mortgage lenders frequently structure loans so that at the end of the loan period, the borrower still owes most of the principal amount borrowed. The last payment balloons to an amount often equal to 85% of so of the principal amount borrowed. Over the term of the loan, the borrower's payments are applied primarily to interest. The homeowner cannot afford to pay the balloon payment at the end of the term, and either loses the home through foreclosure or is forced to refinance with the same or another lender for an additional term at additional cost.

13. Negative Amortization. This involves a system of repayment of a loan in which the loan does not amortize over the term. Instead, the amount of the monthly payment is insufficient to pay off accrued interest and the principal balance therefore increases each month. At the end of the loan term, the borrower owes more than the amount originally borrowed. A balloon payment at the end of the loan is often a feature of negative amortization.

14. Padded Closing Costs. In this scheme, certain costs are increased above their true market value as a method of charging higher interest rates. Examples include charging document preparation of \$350 or credit report fees of \$150, both of which are many times the actual cost.

15. Inflated Appraisal Costs. This is another padding scheme. In most mortgage loan transactions, the lender requires that an appraisal be done. Most appraisals include a typical, detailed report of the condition of the house (interior and exterior) and prices of comparable houses in the area. Other are "drive-by" appraisals, done by someone driving by the homes. The former naturally costs more than the latter. In some cases, borrowers are charged a fee for an appraisal which should include the detailed report, when only a drive-by appraisal was done.

16. Padded Recording Fees. Mortgage transactions usually require that documents be recorded at the local courthouse. State or local laws establish the fees for recording the documents. Mortgage lenders typically pass these costs on to the borrower. Predatory mortgage lenders often charge the borrowers a fee in excess of the actual amount required by law to record the documents.

17. Bogus Broker Fees. In some cases, predatory lenders charge borrowers broker fees when they borrower never met or knew of the broker. This is another way such lenders increase the cost of the loan for the benefit of the lender.

18. Unbundling. This is another way of padding costs by breaking out and itemizing charges which are duplicative or should be included under other charges. An example is where a lender imposes a loan

origination fee, which should cover all costs of initiating the loan, but then imposes separate, additional charges for underwriting and loan preparation.

19. Credit Insurance - Insurance Packing. Predatory mortgage lenders market and sell credit insurance as part of their loans. This includes credit life insurance, credit disability insurance, and involuntary unemployment insurance. The premiums for this insurance are exorbitant. In some cases, lenders sell credit life insurance covering an amount which constitutes the total of payments over the life of the loan rather than the amount actually borrowed. The payout of claims is extremely low compared to the revenue from the premiums. The predatory mortgage lender often owns the insurance company, or receives a substantial commission for the sale of the insurance. In short, credit insurance becomes a profit center for the lender and provides little or no benefit to the borrower.

20. Excessive Prepayment Penalties. Predatory mortgage lenders often impose exorbitant prepayment penalties. This is done in an effort to lock the borrower into the predatory loan for as long as possible by making it difficult for her to refinance the mortgage or sell the home. Another feature of this practice is that it provides back end interest for the lender if the borrower does prepay the loan.

21. Mandatory Arbitration Clauses. By inserting pre-dispute, mandatory, binding arbitration clauses in contractual documents, some lenders attempt to obtain unfair advantage of their borrowers by relegating them to a forum perceived to be more favorable to the lender than the court system. This perception exists because discovery is not a matter of right but is within the discretion of the arbitrator; the proceedings are private; arbitrators need not give reasons for their decisions or follow the law; a decision in one case will have no precedential value; judicial review is extremely limited; a lender will be a frequent user while the consumer is a one-time participant; and injunctive relief and punitive damages will not be available.

22. Flipping. Flipping involves successive, repeated refinancing of the loan by rolling the balance of the existing loan into a new loan instead of simply making a separate, new loan for the new amount. Flipping always results in higher costs to the borrower. Because the existing balance of one loan is rolled into a new loan, the term of repayment is repeatedly extended through each refinancing. This results in more interest being paid than if the borrower had been allowed to pay off each loan separately.

23. Spurious Open End Mortgages. In order to avoid making required disclosures to borrowers under the Truth in Lending Act, some lenders are making "open-end" mortgage loans. Although the loans are called "open-end" loans, in fact they are not. Instead of creating a line of credit from which the borrower may withdraw cash when needed, the lender advances the full amount of the loan to the borrower at the outset. The loans are non-amortizing, meaning that the payments re interest only so that no credit will be replenished. Because the payments are applied only to interest, the balance is never reduced.

24. Paying Off Low Interest Mortgages. A predatory mortgage lender usually insists that its mortgage loan pay off the borrower's existing low cost purchase money mortgage. The lender is able to increase the amount of the new mortgage loan by paying off the current mortgage and the homeowner is stuck with a high interest rate loan with a principal amount which is much higher than necessary.

25. Shifting Unsecured Debt Into Mortgages. Mortgage lenders badger homeowners with telephone and mail solicitations and other advertisements that tout the "benefits" of consolidating bills into a mortgage loan. The lender fails to inform the borrower that consolidating unsecured debt into a mortgage loan secured by the home is a bad idea. The loan balance is increased by paying off the unsecured debt, which necessarily increases closing costs (which are calculated on a percentage basis), increases the monthly payments, and increases the risk that the homeowner will lose the home.

26. Making Loans in Excess of 100% Loan to Value (LTV). Recently, some lenders have been making loans to homeowners where the loan amount exceeds the fair market value of the home. This makes it very difficult for the homeowner to refinance the mortgage or to sell the house to pay off the loan, thereby locking the homeowner into a high cost loan. Additionally, if a homeowner goes into default and the lender forecloses on a loan, the foreclosure auction sale generates enough money to pay off the mortgage loan. Therefore, the borrower is not subject to a deficiency claim. However, where the loan is 125% LTV, a foreclosure sale may not generate enough to pay off the loan and the borrower would be subject to a deficiency claim.

II. SERVICING OF LOAN

1. Forced Placed Insurance. Lenders require homeowners to carry homeowner's insurance, with the lender named as a loss payee. Mortgage loan documents allow the lender to force place insurance when the homeowner fails to maintain the insurance, and to add the premium to the loan balance. Some predatory mortgage lenders force place insurance even when the homeowner has insurance and has provided proof of such insurance to the lender. Even when the homeowner has in fact failed to provide the insurance, the premiums for the force placed insurance are often exorbitant. Often the insurance carrier is a company affiliated with the lender. Furthermore, the cost of force placed insurance is frequently padded because it covers the lender for risks or losses in excess of what the lender may require under the terms of the mortgage loan.

2. Daily Interest When Payments Are Made After Due Date. Most mortgage loans have grace periods, during which a borrower may make the monthly payment after the due date and before the end of the grace period without incurring a "late charge." The late charge is often assessed as a small percent of the late payment. However, many lenders also charge daily interest based on the outstanding principal balance. While it may be proper for a lender to charge daily interest when the loan so provides, it is deceptive for a lender to charge daily interest when a borrower pays after the due date and before the grace period expires when the loan terms provide for a late charge only after the end of the grace period.

III. COLLECTION OF LOAN

1. Abusive Collection Practices. In order to maximize profits, predatory lenders either set the monthly payments at a level the borrower can barely sustain or structure the loan to trigger a default and a subsequent refinancing. Having structured the loans in this way, the lenders consciously decide to use aggressive, abusive collection tactics to ensure that the stream of income flows uninterrupted. The collection departments of predatory lenders call the homeowners at all hours of the day and night, send late payment notices, send telegrams, and even send agents to hound homeowners in person. Some predatory lenders bounce homeowners back and forth between regional collection offices and local branch offices. One homeowner received numerous calls every day for several months, even after she had worked out a payment plan. These abusive collection tactics often involve threat to evict the homeowners immediately, even though lenders know they must first foreclose and follow the eviction procedures. The resulting emotional impact on homeowners, especially elderly homeowners, can be devastating.

2. High Prepayment Penalties. See description I.(20) above. When a borrower is in default and must pay the full balance due, predatory lenders will often include the prepayment penalty in the calculation of the balance due.

3. Flipping. See description in I.(22) above. When a borrower is in default, predatory mortgage lenders often use this as an opportunity to flip the homeowner into a new loan, thereby incurring additional high costs and fees.

4. Foreclosure Abuses. These include a) persuading borrowers to sign deeds in lieu of foreclosure in which they give up all rights to protections afforded under the foreclosure statute, b) sales of the home at below market value, c) sales without the homeowner/borrower being afforded an opportunity to cure the default, and d) inadequate notice which is either not sent or backdated. There have even been cases of "whispered foreclosures," in which persons conducting foreclosure sales on courthouse steps have ducked around the corner to avoid bidders so that the lender was assured he would not be out-bid. Finally foreclosure deeds have been filed in courthouse deed records without a public foreclosure sale.