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Predatory Lending
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Predatory Lending

The Beast of the Sub Prime Market

Are you one of the lucky people? You know, the kind of person who can boast untarnished credit. You have never had a late or missed payment, you wield less than five credit cards, and your credit is well established. The bank offers you the prime rate on every loan, and you would never worry about being turned down. Well, you may be even luckier than you think.

For many of us whose credit is not so shiny and polished, we are at risk for a heartless beast that preys on victims just like us, and its name is Predatory Lending. In 1989, man and government first began to discover the monster that left many hard-working families homeless or demolished people's credit in a seemingly unfixable way. Stands were taken to eradicate the beast forever, but loopholes and the naïve trust of many have kept it alive and strong to this day.

If it is true that you cannot be considered as having good credit, and you are applying for a loan, you will enter the market of sub prime lending, and this is most often the chosen stomping ground of the beast. Even worse, it comes in so many different forms that no single definition has ever been adopted to describe it, but to say that predatory lending is a way of trapping the borrower into a loan with unfair terms, conditions, or interest rates. It is used as a money making tool by corrupt lenders, sometimes working with a group, that coerce or persuade to get the most money that can possibly be squeezed out of an unsuspecting individual. This includes pushing inappropriate loans through that they know are overburdening and will cause a foreclosure. To them, it does not matter that the loan will fail, they will likely get what they wanted and more when they turn around and sell the property; the real goal is to get as many loans approved as they can.

People with less than perfect credit assume that

Predatory lending is most common in the sub prime market, which targets lower income borrowers.

In 2000, public forums on predatory lending were held by the department of Housing and Urban Development and by the U.S. Treasury. Four main types of predatory lending were found:

- 1.) Loan Flipping*
- 2.) Lending without Regard to the Borrower's Ability to Repay*
- 3.) Excessive Fees and "Packing"*
- 4.) Outright Fraud and Abuse*

that they need to accept outrageous interest payments to be accepted for a loan. They can sometimes be talked into believing that their credit is worse than it actually is. This happens especially in certain inner cities where sub prime lending institutions monopolize the whole market. People who need money are perfect targets. The predatory lending advocator uses the borrower's desperation to their advantage. For example, an elderly woman needs to repair a leaky roof on a house she has lived in for 30 years. As if sensing her need, a contractor comes along, gives her a quote, and introduces her to a loan officer who can use her home's equity to solve all the problems. She takes out a loan, using her home as collateral if payments are not made, and hires the contractor to fix the roof and other trouble spots in the home. He does his job, but the elderly woman is finding it increasingly difficult to make such large payments on her fixed income. The loan officer approaches her again, and he offers her to refinance in order to get lower interest rates with lower monthly payments. An appraiser is introduced who inflates the value of the home in order to get enough money to pay off the old loan and the unnecessary charge for paying off the loan earlier than intended. The elderly woman finds that she can make the payments but that she is really only paying off the interest of the loan.

Recently, the department of Housing and Urban Development and the U.S. Treasury held a series of public forums on the issue, as they have been doing for several years. What was discovered is that predatory lending shows itself in four major ways, most of which were used in our example with the elderly woman.

❖ **Loan Flipping-** What generally happens is that a loan officer or mortgage broker encourages a homeowner to repeatedly refinance their home by preying on the borrower's existing debt or by appealing to a desire to lower interest rates. Most often, stiff penalties are paid each time for the crime of paying off the entire loan before it was due. Additional unnecessary fees and terms are added each time the loan is flipped and eventually, the borrower's home equity is completely stripped.

❖ **Lending without Regard to the Borrower's Ability to Repay-** This takes place when low income or fixed income homeowners are given loans with extremely high monthly payments that they are unable to pay. Their home equity is stripped, and their home is considered collateral in the event that the loan should default.

Other methods of predatory lending include “steering” a borrower to a particular lender and using a group to intimidate and coerce a buyer, mandatory arbitration clauses that attempt to legally protect a predatory lender from prosecution, and balloon payments, which is a huge lump sum that is due at the end of a loan.

❖ Excessive Fees and “Packing”- It is true that sub prime lenders are at a higher risk than other lenders, since their client base consists of many people who have a history of defaulting on their loans. Additional and rigorous checking is done into backgrounds and credit history, which costs time and money. However, it happens that borrowers are charged way above what is necessary. The fees and interest that are added onto loans far exceed the risk a borrower poses to a lender, which means a huge profit in the end. In addition, a borrower may be persuaded to take on large fees such as credit life insurance, which assures that a lender will be paid in the event of death, demanding it is mandatory and threatening to delay a loan in the event it is not accepted.

❖ Outright Fraud and Abuse- This includes lenders that are just plain deceptive. They lie, cheat, and steal to get what they want. They know no limits and will go so far as to add on terms to your loan agreement after you have already signed it. They will buy a house for \$60,000, paint the walls, hire a deceptive appraiser to say its worth \$100,000 and turn around and sell it. The lenders that employ methods of abuse and fraud are the most creative of all and are constantly finding new ways to cheat people out of their homes and money.

Another way the predatory lenders trick their clients is by “steering”, which is where a lender “steers” a borrower to deal with certain people, usually those who are making a profit from the unassuming borrower, to complete the deal of the loan. This can include corrupt appraisers, contractors, and mortgage brokers. In addition, some deceptive lenders have started tacking on mandatory arbitration clauses, which attempt to legally protect a lender for their practices of predatory lending. And for those loans with the low monthly payments? When a predatory lender is involved, the borrower is just paying off the interest of the loan and most likely, the entire remainder of the loan is due in one lump sum, or a “balloon payment”, which is due when the loan is termed. Not only does this leave the lender with an attractive profit, but it encourages the borrower to refinance to pay off the first loan, thereby providing the lender with even more money and sending the borrower into a vortex of debt and decreasing assets.

Sub prime lenders are essential in providing many people with loans.

HUD developed a brochure to raise awareness entitled: "Don't be a Victim of Loan Fraud: Protect Yourself from Predatory Lenders." Included, are 11 tips for avoiding deceptive lenders.

While all of this may send less-than-perfect credit borrowers over the brink and into depression, there are ways to avoid becoming a victim. First, it is important to note that not all sub prime lenders are predatory lenders. Let's face it, not all of us are perfect, and the door needs to be opened to allow the opportunity for many to own their own home. It is believed that a very small number of lenders account for the majority of predatory lending, and it is possible to find them before they find you. Following are some tips offered by the department of Housing and Urban Development in their informative brochure: "Don't be a Victim of Loan Fraud: Protect Yourself from Predatory Lenders".

1.) Before you buy a home, attend a homeownership education course offered by the U.S. Department of Housing and Urban Development (HUD)-approved, non-profit counseling agencies (a list can be found on the website.)

2.) Interview several real estate professionals (agents), and ask for and check references before you select one to help you buy or sell a home.

3.) Get information about the prices of other homes in the neighborhood. Don't be fooled into paying too much.

4.) Hire a properly qualified and licensed home inspector to carefully inspect the property before you are obligated to buy. Determine whether you or the seller is going to be responsible for paying for the repairs. If you have to pay for the repairs, determine whether or not you can afford to make them.

5.) Shop for a lender and compare costs. Be suspicious if anyone tries to steer you to just one lender.

6.) Do NOT let anyone persuade you to make a false statement on your loan application, such as overstating your income, the source of your downpayment, failing to disclose the nature and amount of your debts, or even how long you have been employed. When you apply for a mortgage loan, every piece of information that you submit must be accurate and complete. Lying on a mortgage application is fraud and may result in criminal penalties.

7.) Do NOT let anyone convince you to borrow more money than you know you can afford to repay. If you get behind on your payments, you risk losing your house and all of the money you put into your property.

8.) Never sign a blank document or a document containing blanks. If information is inserted by someone else after you have signed, you may still be bound to the terms of the contract. Insert "N/A" (i.e., not applicable) or cross through any blanks.

In 1996, the Mortgage Bankers of America (MBA) stated that their members were aware of \$3 billion in losses due to mortgage fraud. In 2000, MBA members reported \$90 billion.

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9.) Read everything carefully and ask questions. Do not sign anything that you don't understand. Before signing, have your contract and loan agreement reviewed by an attorney skilled in real estate law, consult with a trusted real estate professional or ask for help from a housing counselor with a HUD-approved agency. If you cannot afford an attorney, take your documents to the HUD-approved housing counseling agency near you to find out if they will review the documents or can refer you to an attorney who will help you for free or at low cost.

10.) Be suspicious when the cost of a home improvement goes up if you don't accept the contractor's financing.

11.) Be honest about your intention to occupy the house. Stating that you plan to live there when, in fact, you are not (because you intend to rent the house to someone else or fix it up and resell it) violates federal law and is a crime.

According to only the members of the Mortgage Bankers of America (MBA) in 2000, mortgage fraud accounted for about \$90 billion dollars in losses. Imagine what the amount could be if you include the non-members of the MBA! Considering in 1996 this figure was at about \$3 billion, the problem seems to be growing. Laws have been passed, organizations such as the Appraisal Institute, the MBA, the AARP, the National Home Equity Mortgage Association, the National Credit Union Administration Board and others have adopted moral guidelines and started campaigns to educate their clients, but nothing seems to be able to stop this freight train into economic disaster for many loan borrowers. It can only be hoped that through awareness and understanding by the public, predatory lending will no longer have a place in the sub prime market.

We are continually preparing articles and market studies for the Northeast Indiana marketplace. To get on the contact list, visit our website at www.goodvaluation.com and register as a new user. Make sure to include your email address. For those who may not have email, contact our office, and we will work with you to determine how you can receive future articles. *The information analyzed within this article was obtained from research conducted by the author and others in the research department of Good Valuation, Inc. Information was also obtained from web sites such as HUD, the Appraisal Institute, a La Mode, and Responsible Lending. Opinions expressed are based on observations and analyses conducted by the author.*