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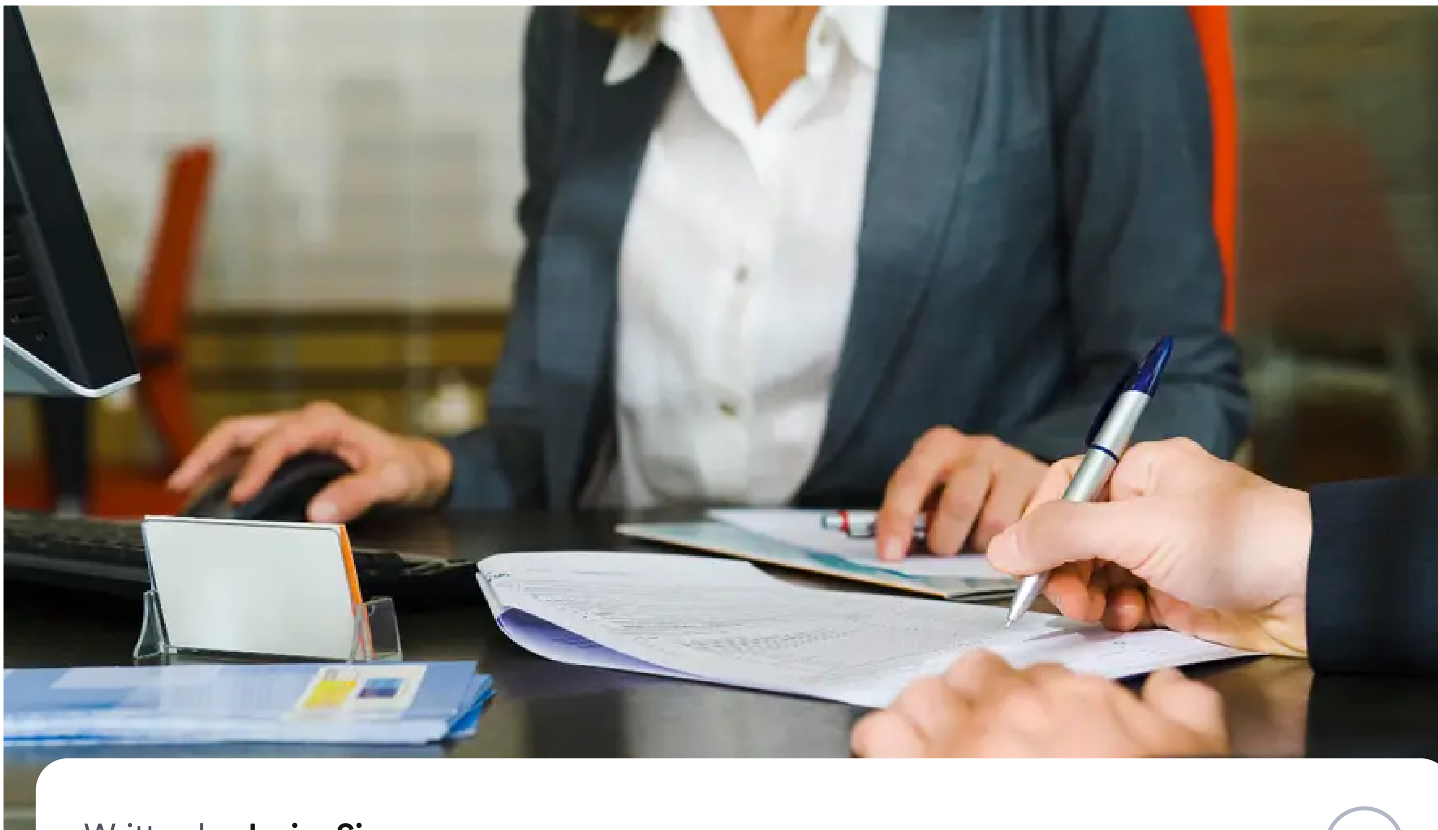
What is predatory lending? Look for these warning signs when you take out a mortgage



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Predatory lending is any unfair practice that diminishes a borrower's ability to repay debt and serves to benefit the lender. Predatory lending tactics may involve loans with high interest rates, hidden and excessive fees, undisclosed terms and more. Predatory lenders typically target vulnerable borrowers and trap them in cycles of debt that can lead to foreclosure and even bankruptcy.

11 warning signs of predatory lending

There are plenty of steps you can take to detect and avoid predatory lending. The first step is identifying red flags that may arise during the homebuying process.

1. High interest rates

Before you apply for a mortgage, you should research current mortgage interest rates. This gives you a good sense of what you can expect. If your credit is fair, you may be quoted something below average. If it needs improvement, you may get quoted a slightly higher rate. If a lender is offering something excessively higher, that's a red flag, and you should look elsewhere.

Current Mortgage Rates for December 9, 2021

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Zip Code: 97213 Portland, OR

Property Value: $ 406,250

Loan Amount: $ 325,000

Loan Term: 30 year fixed

Credit Score: 740+

Show more options

Lender	APR	Rate	Mo. payment	
30 Year Fixed NMLS: #1574660 (5)	2.63% Dec 9, 2021	2.50% Points: 1.232	$1,284 Fees: $5,503	Next
30 Year Fixed NMLS: #330511 (4.2)	2.64% Dec 9, 2021	2.50% Points: 1.748	$1,284 Fees: $5,681	Next
30 Year Fixed NMLS: #1374724 (4.8)	2.64% Dec 9, 2021	2.50% Points: 1.212	$1,284 Fees: $6,010	Next
30 Year Fixed NMLS: #2113062 (5)	2.67% Dec 9, 2021	2.50% Points: 1.7	$1,284 Fees: $7,070	Next

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Andrew Pizor, an attorney with the National Consumer Law Center, recommends that homebuyers shop around for the best rates and closely examine the loan estimate from at least three different lenders. This three-page document shows the estimated interest rate, monthly payment and total closing costs of a loan.

"This is where you'll find discrepancies," Pizor says. "If one is out of line, be suspicious or ask why."

Pizor notes a high rate isn't automatically a form of predatory lending—it may be higher because of your creditworthiness—but an unusually high one is definitely a red flag. He also suggests that consumers pay close attention to the annual percentage rate, or APR.

"These are different from interest rates because they include the costs of fees," Pizor says. "If someone gives you a loan with a 1 percent interest rate and $1 million in closing costs, the interest rate would still be 1 percent."

Moreover, Pizor advises consumers to make sure mortgage points are being applied as agreed. Also called discount points, mortgage points are essentially fees that you pay the lender in exchange for a lower interest rate. Lenders that allow you to pay for mortgage points typically have charts which break down how much a point costs and by what amount that point would lower your rate. Pizor says he's seen cases where homebuyers buy points, but don't end up getting lower rates.

2. Excessive fees

The homebuying process involves plenty of expenses beyond your mortgage. These can include a variety of fees and closing costs. Here are some examples.

- **Appraisal fee:** Paid to a licensed professional who inspects a home to determine its value before a lender will make a mortgage offer. Bankrate estimates this fee to range from $300 to $450.

- **Credit report fee:** Charged by the lender to pull your credit report. It's usually $25 or more per individual.
- **Title search fee:** Forwarded to someone hired by the lender to search local property records in order to analyze the title of the home and ensure there aren't any ownership or lien issues. It typically hovers around $450, but it doesn't apply to a new home.
- **Origination fee:** A fee charged to start the loan process. While many lenders don't charge one, it can rise to as much as $125.
- **Application fees:** Charged by some lenders to process your application.

While simply charging these fees aren't examples of predatory lending in most cases, lenders may intentionally charge excessive prices for them. That's when it becomes predatory, and lenders can unfairly pocket thousands in fees or roll them into your loan, thereby inflating your debt.

Predatory lenders could also charge fees that serve no real purpose other than to make more money off consumers. Pizor suggests you pay attention to vague-sounding items like "administrative fees," and ask what they are for.

"Sometimes, these can just be a hidden profit center," Pizor says.

Identify these fees and how they differ across lenders. Comparing loan estimates can help you spot outliers.

3. Hidden fees

Predatory lenders won't disclose some fees upfront and try to hide them within your documentation. Examples of hidden fees may include prepayment penalties and balloon payments.

4. Prepayment penalties

Prepayment penalties are fees lenders charge when you pay off your mortgage before its term ends, which is known as the period of maturity. So, if you get a windfall and decide to pay off your 30-year mortgage after year two, you may face some unexpected fees.

Fortunately, federal law currently limits prepayment penalties. Lenders can charge prepayment penalties only within three years after your mortgage closes, and they're limited to 2 percent of the loan balance within the first two years and 1 percent during the third year. Lenders must also disclose prepayment penalties within billing documents—but that doesn't mean a predatory lender will make it easy for you to find the disclosure or understand it. Ask about prepayment penalties directly, or avoid loans with prepayment penalties.

5. Balloon payments

Balloon payments are fees that pop up later in the loan term. In this case, you start off with a loan that has a low interest rate and low payments, but you may not be aware that fees will begin to inflate later in the term. Sometimes, these increases can get out of control. Borrowers who can't keep making these payments can lose their homes to foreclosure. In some cases, the predatory lender will offer to refinance the loan into a new mortgage with a fixed interest rate, but the process would involve additional fees pocketed by the lender, who put you in the situation in the first place.

6. Loan packing

Loan packing occurs when a lender packs unnecessary financial products into your mortgage. One example is credit insurance, which pays off your mortgage at death, even if you didn't know about the insurance or didn't need it. Ask about additional components to your mortgage. Remember that lenders typically won't require mortgage insurance (PMI) if you make a down payment of at least 20 percent.

7. Loan flipping

Loan flipping occurs when a lender refinances your loan into one with a higher interest rate and a longer term. While refinancing can be legitimate and beneficial for many borrowers, the goal of refinancing is to pay less in the long run. A predatory lender could flip it into the opposite.

Reputable lenders generally would advise against refinancing unless it's financially beneficial for you. Ron Wynn, a licensed real estate broker in Los Angeles, warns that you should beware of lenders who recommend refinancing multiple times.

"A predatory lender can show you that you should refinance again, while stripping you of more fees and up-front costs," Wynn says. "They keep bringing you back to the table and making more money off you."

8. Negative amortization

Unless you willingly took out a loan that allows you to pay off interest first, your monthly payment should shave off interest and some of the principal balance on your loan. A predatory lender benefits from negative amortization, or when your monthly payment is too small to cover any portion of the interest, so the interest keeps compounding, and you end up paying significantly more in the long run.

Your lender can provide you with charts that show you how much of both the interest and principal balance you're paying off throughout the term of your loan.

9. No credit check

If a lender promises to extend an offer without checking your credit history, steer clear. Credit checks are conducted to evaluate your ability to pay off your mortgage within reasonable terms. A lender that avoids this step may offer you a loan you can't afford and lock you into a cycle of debt that can lead to foreclosure.

10. Access to your bank account

While lenders can't legally force you to provide your bank account number, they can offer to help you set up automatic payments from your account. A predatory lender may use this to force payments out at will, potentially emptying your bank account and leaving you with overdraft fees.

11. Bad reputation

Before you sign anything, take a look at what other consumers have to say about the lender you're considering. A good place to start would be the Consumer Financial Protection Bureau's complaint database. You can also view a list of any complaints registered against the lender by visiting the website of the Better Business Bureau. Here, you can also look at ratings and user reviews. While not always verified, a simple Google search for the lender can pull up some eye-opening information.

How to avoid predatory lending

Do your homework. Even though there are predatory lenders in the homebuying space, there are also plenty of reputable ones that will offer you a reasonable loan based on your ability to repay it. Shop around and compare mortgage rates and fees to know the true cost of homebuying. If you're having trouble finding good rates or terms, try improving your credit before applying for a mortgage. You can also search for government-backed loans like FHA loans and others, which typically have lower rates and less-stringent qualification requirements. When evaluating lenders, look them up on websites like those of the CFPB or BBB to see how they've treated previous customers.

Avoiding predatory lending in the age of COVID-19

Not only is COVID-19 shaking the global economy and the livelihoods of millions, it's also creating a ripe environment for predatory lenders. They are targeting vulnerable individuals who are struggling to make mortgage payments or going into default. These lenders may offer low-cost loans to seemingly pull a consumer out of a financial hole, but actually digs them deeper, or loans with unfair rates and terms, knowing their victims can't reasonably pay them back.

"People are going to be lured by words like 'fast cash,' 'no credit needed,' 'quick turnaround' or anything that implies they don't need income or a job and they can provide you fast cash to turn around your notice of default," Wynn says.

The truth is there are legitimate initiatives designed to help borrowers affected by the coronavirus. On March 18, President Donald Trump directed the Department of Housing and Urban Development (HUD) to halt evictions and foreclosures on homes secured by FHA loans. This initiative also suspended foreclosure proceedings.

If you have a federally-backed loan, you can request forbearance or delay of payments for up to 180 days. You can also apply for a 180-day extension. While interest will accrue during the forbearance, lenders aren't allowed to charge penalties or fees.

Here are some examples of federally-backed loans:

- FHA loans
- VA loans
- USDA loans

Banks are also rolling out their own initiatives to help customers facing financial hardship.

"If you're struggling with your mortgage, lenders are expecting to hear from you," Wynn says. "They can give you forbearance. You don't have to fix this yourself or go somewhere else. Have information ready to show that you're struggling, and they can help you come up with a plan."

How to report predatory lending

If you suspect you've been a victim of predatory lending, contact the CFPB and your state consumer protection organization. The CFPB has a portal where you can submit a complaint, and they can also be reached by phone.

Bottom line, some of the best steps you can take are doing your research, comparing offers from different lenders and becoming an educated buyer.

"Talk to a certified housing counselor," Pizor says. "They're really good at spotting predatory lending. Or take a homebuying class. Most of them are low-cost or free."

Learn more:

- Common mortgage and real estate scams and how to stop them
- Compare mortgage rates
- Steps to finding the best mortgage lender