What is Predatory Lending?

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Wherever there is a pool of low-income homeowners or other groups of individuals who are financially vulnerable, the potential for greedy mortgage companies or con-artists to step in looms large. While the actions of these companies may not always be illegal, the result can be the same: the homeowners may lose their home and the professionals who supposedly 'helped them' end up profiting. These helpers are predators – seeking their prey from the elderly, the sick, the poor. **Predatory lending practices** can leave victims homeless and defeated, stripped of self-respect and hope, their credit ruined.

The definition of predatory lending involves who really benefits in the mortgage transaction. The fact that the *homeowner does NOT benefit* is what turns a legal mortgage into a predatory lending practice which can and should be reported. There are many resources where one can report mortgage fraud and predatory lending. If uncertain whether a mortgage action is legal, or actually fraud or a form of predatory lending, then one should still report it and find out for sure. In many cases only a fine line divides actual fraud from an ethical and legal transaction.

Steering & Coercing
Predatory Lenders use quite a number of different abusive practices when putting together a subprime loan. The possible targets for these practices are the elderly, low-income, or minority homeowners who, in many cases, would actually qualify for a regular prime loan. Fannie Mae estimates that possibly up to 50% of the subprime refinanced loans could have been prime loans – saving the borrowers thousands of dollars in fees and interest rates. The abuse of subprime loans in minority neighborhoods is evidenced by a government study in an African-American neighborhood showing over 51% of the refinanced mortgages being subprime, compared to only 9% in predominantly white neighborhoods. Borrowers are often subjected to very aggressive sales tactics to steer them or coerce them into refinancing when it isn't in their best interest. Many states are attempting to set up **predatory lending laws** to avert this type of activity.

Excessive Fees
A refinanced mortgage can be packed with excessive fees and/or unnecessary fees. A regular mortgage usually will have loan fees below 1% of the total loan amount. A predatory mortgage can have loan fees in excess of 5%. These excessive costs are tucked into the loan amount so the lender can easily disguise them, and these fees can put thousands of the homeowner's dollars into the predator's pockets. This practice falls within the definition of predatory lending.

Insurance and Other Unnecessary Products
Predators often add insurance and other unnecessary products to the loan amount. The insurance they either insist on or intimidate the borrower into buying can include regular mortgage insurance, fire and hazard insurance, life insurance, disability insurance, homeowner's insurance, and health insurance. The insurance can be extended to include all family members, not just the borrowers themselves. The premium for these items is also added onto the loan amount where the cost is not easily spotted by the borrower. And, of course, the predator earns large commissions every year on the premiums paid. A variation of this happens when three or five years of premium are paid in advance.

Abusive and Abnormal Prepayment Penalties
Only about 2% of normal conventional mortgages have a prepayment penalty that might be difficult to meet. Up to 80% of subprime mortgage have an abusive prepayment penalty. Why? This is one more way the predators can gouge an unsuspecting homeowner. The prepayment penalty is a fee the lender requires the borrower to pay if the borrower should pay off the mortgage loan early. The subprime borrower usually has less-than-perfect credit when originally taking out the mortgage, and the prepayment penalty is hidden in the fine print. Over the next few years the borrowers may manage to improve their credit and want to obtain a new mortgage that has lower interest and lower payments. However, the prepayment penalty on the original mortgage (which often equals 5% of the original loan) is so high that it eats up any equity the homeowners have built up and can even leave them owing more money. Homeowners often are trapped into keeping the original, high-interest mortgage. This is also another case where the lender gives a *kickback* to the mortgage broker for helping to include the high prepayment penalty in the mortgage. In the future, when the homeowner has to pay the prepayment penalty, the mortgage broker pockets more money.

Because the predators using high prepayment penalties channel the borrowers into subprime loans, the honest conventional lenders lose a great deal of prime loan business. This indirectly affects the fees they need to charge their regular prime borrowers. Everyone loses when predatory lenders have their way.

Loan Flipping
Another form of predatory lending practices occurs when Con-Artists find a homeowner whom they can talk or coerce into refinancing their mortgage, even though the homeowner gains nothing from the transaction. The process is called *loan flipping*. While the transaction might put a few thousand dollars into the homeowner's bank account, this amount is easily eaten up by the excessive fees, higher interest rate, and prepayment penalties of the new mortgage. A serious danger with loan flipping occurs when a *balloon payment* is inserted into the fine print. While the homeowners originally may have had twenty or thirty years to pay on the mortgage, under the loan flipping they might be signing for a two, three, or five year balloon payment. At the end of that time they need to find a way to refinance the house again or lose it completely. Of course, the 'expert Con-Artists' will be only to glad to do another *loan flip* and refinance it for them – once again pocketing thousands of dollars in the process and leaving the homeowner with even less equity in the property than before.

Mandatory Arbitration
Another practice that falls within the definition of predatory lending happens when a lender hides words in the fine print that make it illegal for the homeowner to take legal action against the lender. The *borrowers sign away their rights to sue the lender for any fraud, predatory actions or illegal actions*. The only right the borrowers have is to take their grievances to arbitration. The arbitration process is totally in the hands of the lenders, usually conducted in secret without the borrowers having adequate representation. Although the borrowers can usually have legal counsel, they find it difficult to find anyone who will represent them because the lawyers are not guaranteed payment of their fees in arbitration like they are in court. Many arbitration cases are handled over the phone and when a small individual is pitted against a large corporation and the proceedings are confidential with no stenographic or written record of the facts, the borrower is at a true disadvantage. Most arbitration decisions are binding and the borrowers cannot appeal them.

More than 50% of the lenders are now including mandatory arbitration in their loan documents, and the borrowers remain unaware of the implications. Lenders favor arbitration because it eliminates a borrower's rights to do a class-action suit against the lender. The Fair Credit Reporting Act and the Truth in Lending Act have no bearing in an arbitration situation, only if one can go to court. And, some lenders keep their right to go to court but prohibit the borrower from doing so. The fees for arbitration can also be more expensive than filing a small claims court suit. Overall, the borrowers who sign a mandatory arbitration contract are bound to a very lopsided arrangement that rarely is in their best interest.

The major arbitration administrators that a borrower can utilize are the National Arbitration Forum, the American Arbitration Association (ADR), and Jams Endispute.

Predatory Lending Laws
Predatory lending laws are slowly being integrated into the legal systems of the federal government and the individual states. More than 35 states have already placed a legal limit on the maximum prepayment penalty that a homeowner should have to pay, and over half of the states have taken steps to limit predatory lending practices during the last five years. While the definition of predatory lending varies in each state, the awareness that individual citizens need to be protected by predatory lending laws is growing.

As more and more homeowners become aware that they have the right to report mortgage fraud and predatory lending, and policy makers, consumer advocates and civil rights leaders take stronger action against the Con-Artists specializing in predatory lending practices, then the elderly, minorities and those with less income are less likely to be prey for predators. Politicians on every level are becoming more aware of the need for predatory lending laws as the Con-Artists multiply, ultimately costing citizens billions of dollars. Organizations like the Center for Responsible Lending, the National Association of Mortgage Brokers, the Mortgage Bankers Association (MBA), and the American Bar Association actively work to promote predatory lending laws. They also know that educating the public is one of the strongest deterrents to mortgage fraud and predatory lending practices. These organizations are committed to providing this education.

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