Housing - Predatory Lending

A dramatic increase in the incidence of predatory lending has created a crisis for communities of color, elderly homeowners, and low-income Americans. States have been moving to curtail predatory lending practices in the home mortgage industry.

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Summary

- **A dramatic increase in the incidence of predatory lending practices has created a crisis for communities of color, elderly homeowners, and low-income Americans.**
- **Predatory lending occurs predominantly in the subprime mortgage industry, and nationally the practice of subprime lending has skyrocketed, growing by 900 percent in only six years.**
- **The increase in predatory lending has been most damaging to the elderly and in minority communities.**
- **About half of subprime borrowers could qualify for a traditional mortgage.**
- **The victims of predatory lending practices are compelled to accept unreasonable loan terms and abusively high fees.**
- **There is a long history of states limiting abusive lending practices through usury laws, but financial industry deregulation and statutory loopholes have made those laws ineffective.**
- **Since 1999, many states have implemented laws to curtail predatory lending practices in the home mortgage industry.**

A dramatic increase in the incidence of predatory lending practices has created a crisis for communities of color, elderly homeowners, and low-income Americans.

The overwhelming majority of abusive loan practices occur in the subprime mortgage industry. Subprime loans are intended for people unable to obtain a conventional prime loan at standard mortgage rates. For legitimate reasons, these loans have higher interest rates to compensate for the potentially greater risk that the borrowers represent. Lending practices are predatory when loan terms or conditions become abusive, or when borrowers who would qualify for credit on better terms are targeted instead for higher cost loans.

Nationally, the practice of subprime lending has skyrocketed, growing by 900 percent in only six years.

In 1993, only 100,000 home purchase or refinance loans were brokered in the subprime market; that number jumped to nearly 1 million loans in 1999. During this same period, all other home purchase and refinance loans declined by 10 percent.[1]

The increase in subprime and predatory lending has been most damaging to the elderly and in minority communities.

Subprime lenders now account for 51 percent of all refinance loans made in predominantly African-American neighborhoods, compared to just nine percent of the refinance loans made in predominantly white neighborhoods.[2] Similarly, almost one in three refinance loans made to low-income Latino families were subprime. One study found that borrowers 65 years of age or older were three times more likely to hold a subprime mortgage than borrowers under 35 years of age.[3]

About half of subprime borrowers could qualify for a traditional mortgage.

The Chairman of Fannie Mae Corporation estimates that as many as half of the borrowers who receive high-cost subprime loans could have instead qualified for traditional mortgages at lower interest rates.[4]

The victims of predatory lending practices are compelled to accept unreasonable terms and abusively high fees.

Borrowers who are not in a position to qualify for an "A" loan are too often required to pay unreasonable rates and fees in the subprime market. Contributing to the problem are incentive systems that reward brokers and loan officers for charging more. Other abusive loan practices found in the subprime industry include: requiring borrowers to purchase single-premium credit insurance, saddling credit-challenged borrowers with unwanted balloon payments and prepayment penalties, and using high-pressure tactics to encourage repeated refinancing by existing customers, tacking on extra fees each time, in a practice known as "flipping."

Predatory lending practices are even more insidious because they specifically target the members of our society who can least afford to be stripped of their equity or life savings.

These same citizens have the fewest resources to fight back when they are cheated—they lack the money to seek legal counsel and the knowledge to contact an appropriate enforcement agency.

There is a long history of states limiting abusive lending practices through usury laws, but financial industry deregulation and statutory loopholes have made those laws ineffective.

Usury laws have been so weakened over the past 20 years that predatory lending practices—modern day loan-sharking—are legal. Although federal law prohibits specific predatory practices, those provisions cover only certain types of loans, and the threshold for what is considered a high-cost loan is set so high that many homeowners are left unprotected.

Since 1999, many states have implemented laws to curtail predatory lending practices in the home mortgage industry.

North Carolina became the first state to prohibit predatory lending in 1999. Since then, legislatures in California, Georgia, New Jersey, New Mexico, New York, and South Carolina have enacted strong predatory lending restrictions, and predatory lending regulations have been adopted in Illinois and Massachusetts as well. A number of other states, including AR, FL, KY, OH, OK and PA have enacted bills that purport to address the problem, but actually provide no additional substantive consumer protections.

State legislation against predatory lending has proven to work.

An economic study of the North Carolina law found that predatory lending practices were reduced while full access to credit for subprime borrowers was maintained.[5]

Effective legislation to prohibit predatory lending practices includes the following elements:

- Limits balloon payments, call provisions, and negative amortization in high-cost home loans.
- Limits prepayment penalties for the first three years of the loan, increased interest rates after a default, and improper payments to home improvement contractors.
- Limits fees to modify, renew, extend or amend high-cost home loans.
- Prohibits "flipping" of home loans—in which refinancing worsens the borrower's financial position.
- Prohibits mandatory arbitration or required broker licensing.
- Requires homeownership counseling for borrowers who seek high-cost loans.

Endnotes

[1] "Unequal Burden: Income and Racial Disparities in Subprime Lending in America," U.S. Department of Housing and Urban Development, April 2000.

[2] "Curbing Predatory Home Mortgage Lending: A Joint Report," U.S. Department of the Treasury and U.S. Department of Housing and Urban Development, June 2000.

[3] AARP, "Subprime Mortgage Lending and Older Borrowers," citing "Subprime Lending: An Investigation of Economic Efficiency," February 2000.

[4] Business Wire, "Fannie Mae Has Played Critical Role in Expansion of Minority Homeownership," March 2, 2000.

[5] Roberto Quercia, Michael Stegman, and Walter Davis, "The Impact of North Carolina's Anti-Predatory Lending Law: A Descriptive Assessment," Center for Community Capitalism, University of North Carolina, 2003.

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For more information...

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Washington, DC 20049
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www.aarp.org

Association of Community Organizations for Reform Now
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Brooklyn, NY 11217
718-246-7900
www.acorn.org

Center for Responsible Lending
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Washington, DC 20013
202-207-0153
www.responsiblelending.org

Community Reinvestment Association of North Carolina
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P.O. Box 1929
Durham, NC 27702-1929
919-667-1557
www.cra-nc.org

Fannie Mae Corporation
3900 Wisconsin Avenue NW
Washington, DC 20016
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www.fanniemae.com

North Carolina Fair Housing Center
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919-667-0888
www.fairhousing.com

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Washington, DC 20410
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www.hud.gov/offices/fheo/lending/predatory.cfm

Predatory Lending Prevention Act

Summary: The Predatory Lending Prevention Act prohibits specific unfair practices in the sale of residential home loans, and provides civil and administrative enforcement procedures.

SECTION 1. SHORT TITLE

This Act shall be called the "[STATE] Predatory Lending Prevention Act."

SECTION 2. FINDINGS AND PURPOSE

(A) FINDINGS—The legislature finds that:

1. A dramatic increase in the practice of subprime lending has occured in the state. Nationally, subprime lending grew 900 percent from 1993 to 1999 and a similar trend occurred in [STATE].

2. Subprime loans are intended for people who, because of blemished credit, are unable to obtain conventional prime loans at standard mortgage rates.

3. While subprime lending is a legitimate practice, expanding access to credit for home ownership, most predatory practices occur in the subprime lending market.

4. Predatory lenders tend to target groups that can least afford to be stripped of their assets—lower income families, minorities, and elderly citizens.

5. The state of [STATE] must act to protect its residents from the most abusive loan practices.

(B) PURPOSE—This law is enacted to protect the equity and property of homeowners, provide needed consumer protections, and safeguard the economic vitality of our state.

SECTION 3. PREDATORY LENDING PREVENTION

After section XXX, the following new section XXX shall be inserted:

(A) DEFINITIONS—In this section:

1. "Annual percentage rate" means the annual percentage rate for a loan, calculated according to the provisions of the federal Truth In Lending Act (15 U.S.C. 1601, et seq.), and the regulations promulgated thereunder by the Board of Governors of the Federal Reserve System (as said Act and regulations are amended from time to time).

2. "Borrower" means any individual obligated to repay the loan, including a co-borrower, cosigner or guarantor.

3. "Flipping" means knowingly refinancing an existing home loan when any of the following occurs:
   a. More than 50 percent of the prior debt refinanced bears a lower interest rate than the new loan.
   b. It will take more than five years of reduced interest rate payments for the borrower to recoup the

transaction's prepaid finance charges and closing costs.
c. Refinancing a special mortgage originated, subsidized or guaranteed by or through a state, tribal or local government, or nonprofit organization, which either bears a below-market interest rate, or has nonstandard payment terms beneficial to the borrower, such as payments that vary with income or are limited to a percentage of income, or where no payments are required under specified conditions, and where, as a result of the refinancing, the borrower will lose one or more of the benefits of the special mortgage.

4. "High-cost home loan" means a home loan where—
a. The total points and fees on the loan exceed five percent of the total loan amount, or
b. The annual percentage rate of interest of the home loan equals or exceeds eight percentage points over the yield on U.S. Treasury securities that have comparable periods of maturity to the loan maturity, as of the 15th day of the month immediately preceding the month in which the application for credit is received by the lender.

5. "Home loan" means a loan, other than a reverse mortgage transaction, where the principal amount of the loan does not exceed the conforming loan size limit for a single-family dwelling as established from time to time by the Federal National Mortgage Association and Federal Home Loan Mortgage Corporation, and the loan is secured by a mortgage or deed of trust on real estate upon which there is located or is to be located a structure or structures, designed principally for occupancy of from one to four families, which is or will be occupied by a borrower as the borrower's principal dwelling. Home loan does not include an open-end line of credit as defined in Part 226 of Title 12 of the Code of Federal Regulations.

6. "Lender" means any entity that originated, or acted as a mortgage broker for, more than five home loans within the previous 12 months.

7. "Points and fees" means—
a. All items required to be disclosed as finance charges under Sections 226.4(a) and 226.4(b) of Title 12 of the Code of Federal Regulations, including the Official Staff Commentary, as amended from time to time, except interest.
b. All compensation and fees paid to mortgage brokers in connection with the loan transaction.
c. All items listed in Section 226.4(c)(7) of Title 12 of the Code of Federal Regulations, only if the person originating the covered loan receives direct compensation in connection with the charge.

8. "Total loan amount" means the same as in section 226.32 of Title 12 of the Code of Federal Regulations.

(B) PROHIBITED PRACTICES FOR ALL HOME LOANS

1. **Deceptive and unfair business practices**—No lender shall:
a. Recommend or encourage non-payment of an existing loan or other debt prior to, and in connection with, the closing or planned closing of a home loan that refinances all or any portion of such existing loan or debt.
b. Coerce, intimidate or directly or indirectly compensate an appraiser for the purpose of influencing his or her independent judgment concerning the value of real estate that is to be covered by a home loan or is being offered as security according to an application for a home loan.
c. Leave blanks in any loan documents to be filled in after they are signed by the borrower.

2. **Financing credit insurance**—No lender shall require or allow the advance collection of a premium, on a single premium basis, for any credit life, credit disability, credit unemployment, or credit property insurance, or the advance collection of a fee for any debt cancellation or suspension agreement or contract, in

connection with any home loan, whether such premium or fee is paid directly by the consumer or is financed by the consumer through such loan. For purposes of this section, credit insurance does not include a contract issued by a government agency or private mortgage insurance company to insure the lender against loss caused by a mortgagor's default.

(C) PROHIBITED PRACTICES FOR HIGH-COST HOME LOANS

1. **Balloon payments**—No high-cost home loan may contain a scheduled payment that is more than twice as large as the average of earlier scheduled payments during the first seven years of the loan. This provision does not apply to a payment schedule that is adjusted to the seasonal or irregular income of the borrower, or a bridge loan with a maturity of less than 12 months that requires only payments of interest until the entire unpaid balance is due.

2. **Prepayment penalties**—No high-cost home loan shall contain a prepayment penalty of more than 3% of the original principal amount of the note in the first year, 2% in the second year, 1% in the third year, or any prepayment penalty beyond the third year.

3. **Negative amortization**—No high-cost home loan may include payment terms under which the outstanding principal balance will increase at any time over the course of the loan because the regular periodic payments do not cover the full amount of interest due. This provision does not apply to a payment schedule that is adjusted to the seasonal or irregular income of the borrower.

4. **Increased interest rate**—No high-cost home loan may contain a provision that increases the interest rate after default. This provision does not apply to interest rate changes in a variable rate loan otherwise consistent with the provisions of the loan documents, provided the change in the interest rate is not triggered by a default or the acceleration of indebtedness.

5. **Advance payments**—No high-cost home loan may include terms under which more than two periodic payments required under the loan are consolidated and paid in advance from the loan proceeds provided to the borrower.

6. **Call provisions**—No high-cost home loan may contain a provision that permits the lender, in its sole discretion, to accelerate indebtedness. This provision does not prohibit acceleration of the loan in good faith due to the borrower's failure to abide by the material terms of the loan.

7. **Home improvement contracts**—A lender may not pay a contractor under a home improvement contract from the proceeds of a high-cost home loan unless the instrument is payable to the borrower or jointly to the borrower and the contractor, or, at the election of the borrower, through a third-party escrow agent in accordance with terms established in a written agreement signed by the borrower, the lender, and the contractor prior to disbursement.

8. **Flipping**—A lender may not offer a high-cost home loan while engaged in the practice of flipping.

9. **Modification or deferral fees**—A lender may not charge a borrower any fees or other charges to modify, renew, extend or amend a high-cost home loan, or to defer any payment due under the terms of a high-cost home loan, except when the borrower is in default of the loan.

10. **Homeownership counseling**—A lender may not originate a high-cost home loan without first receiving certification from a counselor approved by the U.S. Department of Housing and Urban Development, a state housing financing agency, or the regulatory agency which has jurisdiction over the lender, that the borrower has received counseling on the advisability of the loan transaction.

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(D) ENFORCEMENT

1. **Civil remedies**—This Act may be enforced by a private cause of action under [appropriate section of state statutes].
2. **Administrative remedies**—This Act shall be enforced by [appropriate state oversight agency], which shall promulgate such rules and regulations as are necessary to implement and administer compliance with the Act.

SECTION 4. SEVERABILITY

The provisions of this Act shall be severable, and if any phrase, clause, sentence or provision is declared to be invalid or is preempted by federal law or regulation, the validity of the remainder of this Act shall not be affected thereby.

SECTION 5. EFFECTIVE DATE

This Act shall take effect on July 1, 2004.