

# PREDATORY MORTGAGE LENDING

## ROBS HOMEOWNERS & DEVASTATES COMMUNITIES



### FINANCIAL SABOTAGE

“Bad credit? No problem!” Unscrupulous mortgage brokers and lenders use lines like this to aggressively target families and steal their single largest source of wealth—home equity. As families work hard to build wealth through homeownership, abusive loans can quickly sabotage their progress and even push them into foreclosure.

Predatory lending is most common in the subprime market, where home loans cost more and often come with monthly payments that increase over time. Subprime loans result in foreclosure far more frequently than mainstream “prime” loans. To make matters worse, many of the families steered into high-cost subprime loans could qualify for more affordable, less risky financing.

Only a decade ago, the subprime market was a small fraction of the home loan market. At year-end 2005, it had grown into a \$665 billion business,

representing about 20 percent of all home loans. Policymakers are faced with the challenge of balancing the economic benefits of this growing industry with the need to place appropriate restrictions on unscrupulous lending practices.

### STATE LAWS ARE WORKING

Current federal law does not address many widespread abuses in the subprime market, such as fee-packed refinances, exorbitant prepayment penalties, and common pricing practices that can lead to unfair discrimination. Fortunately, 31 states have taken specific actions to prevent predatory lending in the subprime market. Recent CRL research shows that state laws have been highly successful, producing these positive effects:

- A significant drop in abusive loans, with growing access to responsible subprime mortgages;
- Comparable or even lower interest rates; and

- The spread of better lending practices nationwide.

### PREDATORY PRACTICES

Predatory mortgage lending involves a wide array of abusive practices. Here are brief descriptions of some of the most common:

**Excessive fees:** Points and fees are costs not directly reflected in interest rates. Because these costs can be financed, they are easy to disguise or downplay. On competitive loans, fees below one percent of the loan amount are typical. On predatory loans, fees totaling more than five percent of the loan amount are common.

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### WHAT MAKES PREDATORY LENDERS SUCCESSFUL?

**Deceptive marketing. Rushed loan closings with reams of paper. And few legal barriers to stop abusive practices.**

### FAST FACTS

Predatory lending is concentrated in the subprime mortgage market, which targets families with weaker credit.

Over 80% of subprime loans come with adjustable interest rates, making them higher risk for financially at-risk families.

Roughly one out of five subprime home loans goes into foreclosure at least once.

African-American and Latino borrowers are much more likely to get higher-rate subprime loans than white borrowers with the same qualifications.

Borrowers age 65 and older have five times the odds of receiving a subprime loan than borrowers younger than 35.

At least 30 states have taken action against predatory lending, providing stronger protections for families and a better market for responsible lenders.

### CRL MISSION

The Center for Responsible Lending is a nonprofit, nonpartisan research and policy organization dedicated to protecting homeownership and family wealth by working to eliminate abusive financial practices. CRL is affiliated with Self-Help, one of the nation’s largest community development financial institutions. Please visit our website at [www.responsiblelending.org](http://www.responsiblelending.org).



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## PREDATORY MORTGAGE LENDING Continued

### Abusive prepayment penalties:

Homeowners with higher-interest subprime loans have a strong incentive to refinance as soon as their credit improves, but the majority of subprime mortgages carry a prepayment penalty—a fee for paying off a loan early. In the subprime market, families routinely pay a heavy price for improving their credit and qualifying for a better loan.

### Kickbacks to brokers

**(yield-spread premiums):** A “yield-spread premium” is extra cash brokers receive from lenders for delivering loans with inflated interest rates (i.e., higher than the rate the lender is willing to accept). These kickbacks may help explain why African Americans and Latinos often get loans with higher interest rates compared to white borrowers with the same qualifications.

**Loan “flipping”:** A lender “flips” a loan by refinancing it to generate fee income without providing any ultimate benefit to the borrower. Flipping can quickly drain home equity and increase monthly payments—sometimes on homes that had previously been owned free of debt.

### THE COST OF ABUSIVE PREPAYMENT PENALTIES:

**A typical prepayment penalty on a subprime mortgage costs thousands of dollars. For example, on a loan with a 10% interest rate, a homeowner with a \$150,000 mortgage would be forced to pay \$6,000 before refinancing.**

### Loose qualifying standards

**on high-risk loans:** Subprime lenders often fail to consider a family’s ability to repay adjustable-rate mortgages, including taxes and insurance, after the initial introductory period is

over. In some cases, lenders do not even require standard proof of income, making an already risky loan even more dangerous. In 2006, a surge of serious delinquencies on adjustable-rate loans provided an early indication that many families are struggling with these loans.

**Mandatory arbitration:** Some loan contracts require “mandatory arbitration,” meaning that the homeowners are not allowed to seek legal remedies in a court if they find that their home is threatened by loans with illegal or abusive terms. Mandatory arbitration makes it much less likely that victims will receive fair and appropriate remedies in cases of wrongdoing.

### Steering and targeting:

Predatory lenders may steer families into subprime mortgages, even when the family could qualify for a mainstream loan. Steering often involves aggressive sales tactics and sometimes outright discrimination. As early as 2000, government agencies found that African-American families living in upper-income neighborhoods were more likely to receive subprime loans than white families living in low-income neighborhoods.

**In 2001, we estimated that predatory mortgage lending costs homeowners \$9.1 billion each year. At that time, the subprime market was less than 8% of the total mortgage market. Today, given that subprime loans make up 20% of the market, it is more urgent than ever to ensure that families are free to build wealth through ownership without fearing predators.**

## PREDATORY BROKERS DON'T PLAY FAIR

An 84-year-old woman struggled to keep her home after a mortgage broker persuaded her to refinance. The woman’s original home loan for \$34,000 had a 15-year term with a 7% interest rate. The victim was lured into an equity-stripping loan that was boosted up to \$56,000 with an initial interest rate of 9.8%—a rate that went higher over time and ultimately forced her into foreclosure.\*

\*David Nicklaus, “Don’t Make a Federal Case of Subprime Mortgages” *St. Louis Post-Dispatch* (March 22, 2006).

## POLICY RECOMMENDATIONS

### Homeowners need stronger protections to protect hard-earned wealth against predatory lenders. Any effective laws should offer these safeguards:

- Prohibit exorbitant and abusive fees.
- Ensure families get loans they can afford to repay.
- Eliminate kickbacks that reward brokers for steering homeowners into unnecessarily costly loans.
- Prohibit abusive prepayment penalties on subprime loans.
- Require counseling for high-cost loans.
- Limit the financing of fees in high-cost loans.
- Prevent loan “flipping” by requiring all refinance loans to provide homeowners with a reasonable net benefit.
- Protect homeowners’ ability to protect their homes from foreclosure.
- Ensure homeowners have full access to the court system to settle conflicts with lenders.
- On any new federal law, protect states’ rights to protect their citizens from predatory lending.

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## SCOPE OF WORK

**CRL’s staff includes attorneys, researchers, and policy analysts in North Carolina, Washington, D.C., and California who study and report on predatory lending matters, and monitor legislative and regulatory activity in state capitals and the US Congress. Its scope of work includes:**

**Policy and Technical Assistance:** knowledge-sharing with advocates throughout the country.

**Research:** credible CRL reports and studies are gleaned from housing reports and lender information.

**Coalition-Building and Constituency Relationships:** CRL builds and maintains strong relationships with national organizations concerned about predatory lending.

**Litigation:** CRL partners with other advocates to submit legal briefs on important issues of law relating to predatory lending.

**Communications and Web Site:** CRL—in collaboration with state and national partners—is promoting public awareness of predatory lending. The CRL web site ([www.responsiblelending.org](http://www.responsiblelending.org)) is a proven resource.