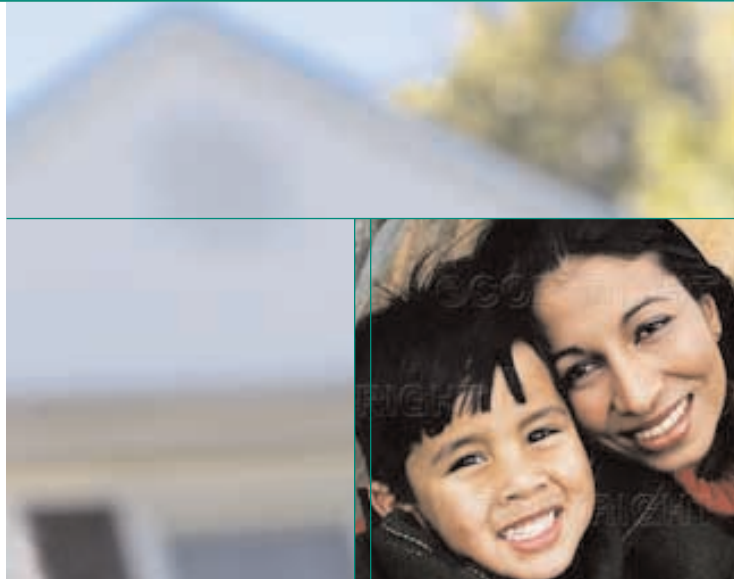


# PREDATORY MORTGAGE LENDING

## ROBS HOMEOWNERS & DEVASTATES COMMUNITIES



**IN** recent years, homeownership opportunities have expanded significantly as mortgages have become more widely available to borrowers with weaker credit histories. Unfortunately, opportunities also have expanded for predatory lenders to strip home equity families have acquired over a lifetime of making mortgage payments. The Center for Responsible Lending (CRL) estimates that abusive home mortgage lending practices cost homeowners \$9.1 billion each year.

Predatory lenders often target borrowers with challenging or even precarious financial situations. Most abusive practices occur in the subprime market—home loans for people with impaired or limited credit histories. Not all subprime loans are predatory, but nearly all predatory loans are subprime.

Between 2002 and 2003, subprime lending increased by 50%, from \$213 billion to

\$332 billion. Today, 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, such as fee-packed refinances, flipping, and exorbitant prepayment penalties (see “Predatory Practices”). Fortunately, many states have passed predatory lending laws to supplement federal protections. Recent research shows that state laws are having their intended effects.

The longest track record has been established in North Carolina, where state lawmakers passed groundbreaking legislation to curb predatory lending practices in 1999. Since then, subprime lending in North Carolina has continued to

thrive. At the same time, the state has experienced a drop in predatory loans—exactly as intended. Citizens in North Carolina and other states with strong anti-predatory lending laws still have plenty of access to credit, as evidenced by the strong, continuous growth of subprime lending throughout the nation.

### 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 1% of the loan amount are typical. On predatory loans, fees totaling more than 5% of the loan amount are common.

Continued >>>

### FAST FACTS

During the past ten years, the subprime mortgage industry has grown 1000%.

Up to half of subprime borrowers could qualify for mainstream conventional loans.

About 75% of subprime mortgages in 2001 and 2002 were refinances.

In 2002, upper-income African-Americans in predominantly African-American neighborhoods were 3 times more likely to have a subprime purchase loan than low-income white borrowers.

In 2002, Latinos and African-Americans were 2.5 and 4.1 times, respectively, more likely than whites to receive a refinance loan from a subprime lender.

Borrowers age 65 and older have 5 times the odds of receiving a subprime loan than borrowers younger than 35.

North Carolina’s anti-predatory lending law saves homeowners an estimated \$100 million each year.

### 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).



302 W. MAIN ST., DURHAM, NC 27701  
PHONE 919 313 8500

910 17<sup>TH</sup> STREET NW, SUITE 500  
WASHINGTON, DC 20006

## PREDATORY MORTGAGE LENDING *Continued*

### Abusive prepayment penalties:

Borrowers with higher-interest subprime loans have a strong incentive to refinance as soon as their credit improves. However, up to 80% of all subprime mortgages carry a prepayment penalty—a fee for paying off a loan early. An abusive prepayment penalty typically is effective more than three years and/or costs more than six months' interest. In the prime market, only about 2% of home loans carry prepayment penalties of any length.

### Kickbacks to brokers (yield spread premiums):

When brokers deliver a loan with an inflated interest rate (i.e., higher than the rate acceptable to the lender), the lender often pays a “yield spread premium”—a kickback for making the loan more costly to the borrower.

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

### Unnecessary products:

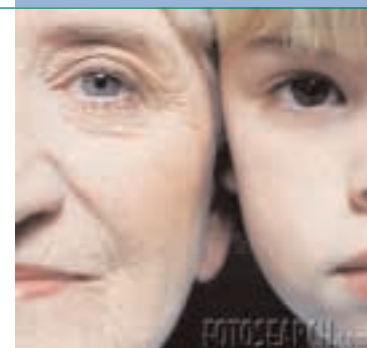
Sometimes borrowers may pay more than necessary because lenders sell and finance unnecessary insurance or other products along with the loan.

**Mandatory arbitration:** Some loan contracts require “mandatory arbitration,” meaning that the borrowers 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 borrowers will receive fair and appropriate remedies in cases of wrongdoing.

**Steering:** Predatory lenders may steer borrowers into subprime mortgages, even when the borrowers could qualify for a mainstream loan. Vulnerable borrowers may be subjected to aggressive sales tactics and sometimes outright fraud. Fannie Mae has estimated that up to half of borrowers with subprime mortgages could have qualified for loans with better terms.

**Targeting:** According to a government study, over half (51%) of refinance mortgages in predominantly African-American neighborhoods are subprime loans, compared to only 9% of refinances in predominantly white neighborhoods.

Figures cited in this overview come from CRL research and a number of other sources, including Fannie Mae, the AARP, the National Housing Institute and government reports.



## BEHIND THE NUMBERS: Personal Tragedies

Some of the most egregious cases of predatory lending involve older citizens on limited incomes. Consider the plight of 89-year-old Dezell Wiley, a Durham, N.C. woman who was persuaded to refinance her mortgage five times in four years. Each incidence of loan flipping bloated her mortgage further, as the lender added new closing costs and excess fees to the previous debt. Ultimately, Ms. Wiley owed more than \$70,000 on a house she had previously owned free and clear, requiring her to spend nearly all of her Social Security income to make her monthly payments.



## POLICY RECOMMENDATIONS

**Homeowners need stronger protections to protect home equity and neighborhoods from being preyed upon by unscrupulous lenders. Any effective law should offer these safeguards:**

- Provide incentives to decrease exorbitant and abusive fees.
- Eliminate kickbacks that reward brokers for steering homeowners into unnecessarily costly loans.
- Create strong disincentives for abusive prepayment penalties.
- 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 tangible 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.
- Preserve the ability of states 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 and Washington, DC who study and report on predatory lending matters and monitor legislative and regulatory activity in state capitols and in the US Congress. CRL's work has five main components:**

**Policy and Technical Assistance:** sharing market and legal knowledge with advocates and policymakers across the country interested in reforming lending practices.

**Research:** conducting and publishing research on predatory lending to inform policymakers, advocates, and others on its extent and impact on borrowers and communities.

**Coalition-Building:** supporting national and state organizations concerned about predatory lending.

**Litigation:** partnering with other advocates to advance predatory lending litigation and submitting legal briefs on important issues of law.

**Communications:** promoting public awareness of predatory lending issues and providing a web-based archive of information for local legislators and advocates.