MIDPENN LEGAL SERVICES

Keynotes

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Predatory Mortgage Lending

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Mr. and Mrs. Gerry are an elderly couple from Lancaster County. They are retired and have been living on a fixed income for many years. Both have multiple health problems. After years of struggling to make their mortgage payments, the Gerry's paid off their mortgage in 1997.

In 1999 a subprime-lender convinced them to take out a home equity loan so that they would have "extra income." The Gerry's always paid their loan on time and in 2002, they were again contacted by the lender and urged to consolidate their debt. Trusting the loan officer, the couple never asked about the interest rate or the other details of their loan, nor did the subprime-lender tell them about any of the details. The couple assumed that with their good credit that they would get the best possible rate that the lender had to offer.

The Gerry's received an eight-year mortgage for $65,409 at an 11.1% interest rate (when 'A' rates were around 6.8%). Their monthly payments were $1,031 – over half of their fixed monthly income. The subprime-lender financed into the loan $6,541 in their own fees – more than 10% of the loan amount – plus $598 in third party charges, $2,278 for single premium credit life insurance policy, and $950 for a Home and Auto Security Plan. Altogether, this subprime lender stripped nearly $10,000 in equity from the Gerry's on a $65,000 loan. To top it off, the lender locked the Gerry's into the high rate with a five year prepayment penalty of $2,850 on a loan that lasts only eight years.

Sound familiar? This elderly couple is just one of hundreds of families in Pennsylvania who have been robbed by **predatory lenders – mortgage and finance companies which make loans at high interest rates with exorbitant fees and harmful terms, often through fraudulent and deceptive methods.**

Elderly homeowners and low-income and minority communities are the most severely impacted by these practices.

The subprime loan industry is a fertile breeding ground for predatory lending because by their nature, subprime loans are intended for individuals who are unable to obtain a conventional market-rate loan at the standard bank rate. Subprime loans have higher interest rates to compensate for the potentially greater risk that these borrowers represent to the lender.

While there is a legitimate place for credit arrangements for those individuals who do not qualify to get loans on 'A' terms, predatory lending occurs when the loan terms or conditions become abusive, exorbitant, and overstate the risk involved or when borrowers who should qualify for better loan terms are targeted instead for high cost loans.

What follows is a summary of the most common types of predatory mortgage lending occurring in Pennsylvania. While this list is not complete, it shows the problems that many low-income families face.

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If any of the following sound familiar, you may be the victim of a predatory loan.

►**Aggressive and Deceptive Marketing:** Most victims of predatory lending have one thing in common: **They were contacted by the lender.** The **predatory loan business is based** not on the competition between rates or terms offered by other subprime lenders, but **on which lender can reach and "hook" the borrower first**. Predatory lenders target low-income and minority communities that may have been denied credit by banks and reputable lending institutions.

One successful method is the practice of sending **"live checks" in the mail** to target homeowners. The checks are usually for several thousand dollars. Cashing or depositing the check means the borrower is entering into a loan with the lender. The appeal of the checks is that they are fast cash for the homeowner. These checks are an initial entry point into the financial life of the borrower. The loan has an artificially high interest rate and monthly payment in order for the predatory lender to be able to offer the borrower the opportunity to refinance it, and other unsecured debts into another loan at a slightly lower rate. The ultimate goal of the predatory lender is to get the homeowner to refinance their entire mortgage with them. This practice is know as "loan flipping."

►**Loan Flipping:** Loan flipping is the practice in which a lender, often through high pressure tactics, **encourages repeated refinancing by existing customers and tacks on thousands of dollars in additional fees** or other charges each time. This kind of multiple refinancing is **never beneficial to the borrower** and is a good indicator that the loans in question are predatory.

►**Property Flipping:** Property flipping **is an elaborate scam targeting first-time homebuyers who are sold homes in a serious state of disrepair at prices far above what the houses are worth.** The typical property flip begins with an investor or real estate company purchasing a distressed property for as little as a few thousand dollars. After doing minimal, cosmetic repairs, the owner finds a buyer by targeting low-income, minority communities. The buyers having no representative of their own and no real estate knowledge, are at the mercy of the seller. The seller lies about the condition of the property, promises to make "visibly" needed repairs after closing, sets the sales price far above the property's actual value and refers the buyer to a subprime lender who acts as a "one-stop shop" for the closing.

Many subprime lenders will only make a purchase loan if the loan is for 80% or less of the value of the property. The seller will use a variety of schemes for it to appear that the borrower has the required 20% down payment. For instance, the seller will often get the buyer to sign false gift letters and deposit money into a "dummy" bank account and/or will execute a second mortgage, which exists on paper only. The key to the scam is having a lender that will use appraisers who will support the property's inflated sales price. For their participation, the lender is compensated by the fees and additional charges on the loan, which are often inflated and excessive given the artificial sales price. Many of these loans are insured by the Federal Housing Authority so if the buyer defaults the lender is fully compensated for the loan amount despite the fact that the home is worth much less than what it was sold for.

►**Excessive Fees: Predatory lenders often finance huge fees into loans**, stripping thousands of dollars in equity – or the amount by which the value of your home is greater than what you owe to the bank. For instance, borrowers in predatory loans are routinely charged fees of just under 8% of the loan amount, compared to the average 1% assessed by banks to originate loans. You may not even know that you were charged these high fees without looking at the loan documents because most predatory lenders wrap the fees into the loan. If the price you paid for the house or the amount that you received or used to pay other debts (in the case of a refinance) is considerably less than the amount of the loan, you may have been charged excessive fees and your loan may be predatory.

►**Prepayment penalties:** The vast majority of predatory loans have prepayment penalties. These **penalties come due when the borrower pays off their loan early**, typically through refinancing or sale of the house. The penalties remain in force for periods ranging from two to five years of the loan and are often as much as six months' interest on the loan. For a $50,000 loan at 11% interest, the penalty would be over $2,500, which would be financed into the new loan. For borrowers who refinance or sell their houses during the period covered by the prepayment penalty, the penalty functions as an additional and expensive fee on the loan.

►**Home Improvement Scams:** Some home improvement contractors deliberately target their efforts to lower income neighborhoods where homes are in the most need of repairs, and where the owners are unable to pay for the service. The contractor tells the homeowner that they will arrange for the financing to pay for the work. They refer the homeowner to a specific broker or lender. Sometimes the contractor begins work before the loan is closed, so that even if the borrower has second thoughts about the loan, they are forced into it in order to pay for the work. The lender then may make payments directly to the contractor, which means that the homeowner has no control over the quality or timing of the contractor's work. As a result, even if the work is done improperly, or not at all, the homeowner is stuck with a high-interest, high fee loan.

Tips to Remember:

✓**Before you begin loan shopping, visit your local non-profit housing counseling center.** Talk to a counselor to evaluate your financial situation and to discuss your loan needs. You may actually qualify for a lower cost bank loan.

✓**Ignore high-pressure solicitations**. Before you sign anything, take the time to have an expert – such as a housing counselor or lawyer – look over any purchase agreement, offer, or any other documents.

✓**Don't agree to or sign anything that doesn't seem right** even if the seller or lender tells you that "it's the only way to get the loan through" or "that's the way it's done." Look over everything you sign. Make sure all your information is correct. Do not sign blank loan documents or documents with blank spaces "to be filled out later."

✓**Before closing your loan, get a copy of your loan papers with the final loan terms and conditions** so you have enough time to examine them. If anything is dramatically different at closing, don't sign it.

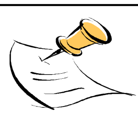
✓**Don't accept a lender's statement that you have bad credit** without seeing your credit report yourself. Check for mistakes and inaccuracies. Have an independent person evaluate your credit.

✓**Make sure you are comparing apples to apples**. Know exactly what debts will and will not be paid and if your new payment will include taxes and insurance. You should also understand if the payment being quoted is sufficient to pay off the loan or only goes toward the interest.

✓**Be wary of any lender or broker who encourages you to refinance your first mortgage if that's not what you are looking to do** or if encouraged to add more and more of your other debts into the loan.

For more information about predatory lending call toll-free: South Central Assembly for Effective Governance Predatory Lending Information Hotline: 1-866-551-0239 **OR** ACORN (Association of Community Organizations for Reform Now): 1-877-692-0233.

If you are being threatened with mortgage foreclosure or have been sued over your home loan call your local MidPenn Legal Services office.



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Martin Luther King Fellowship

The first recipient of a Martin Luther King Fellowship in Pennsylvania is working at MidPenn Legal Services. Attorney Sharele Tucker joined the legal aid staff at their Chambersburg office for a two year fellowship. Attorney Tucker is a life-long resident of Chambersburg and a 2001 graduate of Widener Law School. Before coming to MidPenn, Attorney Tucker was on active duty in the Army most recently having served in Iraq. The Martin Luther King Fellowship is sponsored by Pennsylvania Legal Services, the principle funder of civil legal aid programs in the state. The Fellowship has been developed to provide the means for law school graduates to work in public interest law.

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