

Seven signs of predatory lending

What to look for in a loan

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Borrowers should remember that they are not obligated to sign a loan just because they are at closing. If the terms of a loan look different at closing than expected or if the borrower has second thoughts, seeking legal or financial counseling is a far better bet than getting locked into a loan that can turn the American dream into a nightmare. For more information, borrowers should look at www.dontborrowtrouble.com. According to the Center for Responsible Lending, these are warning signs of predatory lending borrowers should look for:

1. Credit insurance is usually a lousy deal.

Buying life, disability, unemployment, or property insurance with your loan is almost always a bad idea. Credit insurance is overpriced and hard to collect on. When the cost of the insurance is rolled into the loan, the lender makes even more money by charging high interest on the premiums. Some subprime mortgage lenders have begun charging a monthly fee for insurance rather than rolling it into the debt and charging interest. But even that is expensive and abusive, sometime costing the borrower hundreds of dollars each year. If you feel you need protection, an independent insurance agent can usually sell you insurance that is not only cheaper but provides much higher coverage in the case of death or other misfortune.

1. Excessive fees can add thousands to the cost of your loan.

Traditional banks, credit unions, savings and loans, and thrifts have seen increased competition to offer the lowest fees. However, predatory lenders see fees as the best way to make quick money. In one infamous example, a lender faced a class-action lawsuit for charging borrowers 25 percent of a home loan amount in fees while portraying the loans as “no-cost” since they were all financed and the borrower did not have to pay out any cash at closing. Borrowers should insist on receiving a “good faith estimate” at the time of application, and on their right to review documents the day before closing to scrutinize fees. If fees paid to a lender and/or mortgage broker total more than three to five percent of the total loan amount, borrowers should consider putting off closing and looking for another loan.

2. Watch out for abusive prepayment penalties.

One fee that is often overlooked by borrowers is called a prepayment penalty. Rare in the prime market (less than 2 percent of prime loans contain them), prepayment penalties are contained in 80 percent of the loans in the subprime market. These hidden, confusing fees trap borrowers in high-rate loans, which can lead to foreclosures. A common example of an abusive prepayment penalty is six months' interest on prepayments made in the first five years of a loan. So, for example, a \$100,000 loan at an interest rate of 10 percent could have a prepayment penalty of as much as \$5,000.

3. Mandatory arbitration takes away your right to a day in court.

Mandatory binding arbitration clauses insulate unfair and deceptive practices from effective review and relegate consumers to a forum where they may not obtain injunctive relief against wrongful practices, proceed on behalf of a class, or obtain punitive damages.

4. Mortgage broker kickbacks add to the hidden cost of the loan.

Brokers are paid in several ways—including out-of-pocket payments from a borrower, financed payments from a borrower, and indirectly by a lender for the borrower. In the latter, the lender pays the broker a kickback for placing a borrower in a loan with an interest rate higher than that for which the borrower qualifies. These payments show up on a closing statement as yield spread premiums, service release premiums, or as “paid outside of closing” (sometime abbreviated at YSP, SRP, or POC). While borrowers are often told not to worry since the payment is from the lender, the truth is that the only one paying money in a transaction is the borrower. Borrowers should look to see if they think *all* compensation paid to a mortgage broker is fair—not just payments from their pocket.

5. Subprime lenders want to steer you into high-cost loans, even if you have good credit.

While lenders often send borrowers with less than perfect credit to their subprime affiliates, too few refer borrowers up for a better loan. In fact, some lenders “steer” borrowers into higher-cost loans. Studies by the U.S. Department of Housing and Urban Development have suggested that steering has a racial impact since borrowers in African-American neighborhoods are five times more likely than whites to get a subprime loan. To protect themselves from this abuse, borrowers can shop around and consult with housing counselors certified by state agencies before entering a loan.

6. *Loan flipping can make your debt spiral out of control.*

“Flipping” is the practice of refinancing subprime loans over and over, taking out home equity in the form of high fees each time, without providing the borrower with a net tangible benefit. Borrowers are often baited for a flip when they are given a loan with unwanted terms (such as a variable rate) and then encouraged to refinance. On each loan, the lender strips out equity through fees.

The most important financial advice you'll ever get: Don't sign any document you don't understand.

Read everything you sign. If you have trouble reading or understanding financial document, bring along someone you trust who does. Just because a loan officer is friendly doesn't mean he or she is on your side. Check and question everything: the interest rate, the closing fees, the insurance, whether it's a mortgage on your home or not. And if your loan officer tries to rush you through signing, that's a clear indication that someone's trying to pull the wool over your eyes. Loan officers often try to flip and fold loan documents so you can't see everything before you sign. If something like that happens, walk away. The only thing worse than being in financial trouble is signing for a predatory loan that traps you in even deeper trouble.