

## **EXCERPT FROM *STOP PREDATORY LENDING: A GUIDE FOR LEGAL ADVOCATES***

© National Consumer Law Center 2002

Reprinted with the permission of the National Consumer Law Center

### **2.3.7 Warning Signs of a Predatory Mortgage Loan**

This list contains areas of potential concern. You will not find all or even most of these red flags in each loan transaction. However, if the loan is overreaching or expensive, this list will sharpen your instincts and assist you in identifying what is wrong. When reviewing loan documents, make a list of the red flags that warrant further investigation. Chapter 6 helps you to sort through the relevant documents; Chapter 7 helps you to analyze them. Chapters 3 and 5 describe the legal claims that might arise based upon the warning signs you discover. Chapter 8 contains checklists to organize your approach to each case.

The warning signs of a predatory loan are broken down into three categories: what happened leading up to the signing of the loan (marketing and sales, and the application); what happened at the closing (the loan documents and how the closing was conducted); and post-closing behavior.

Due to the nature of the beast, this list is not exhaustive. Predatory lending practices are limited only by the imagination of the predator. If something seems off or smells bad to you, even if not on this list, trust your instincts. You are on the right track.

#### **2.3.7.1 The Marketing and Sales of Mortgage Loans**

- Aggressive solicitations of targeted neighborhoods<sup>1</sup>
- Steering to high rate lenders
- Door-to-door solicitation of home improvement or financing arranged by contractor or mobile home dealer
- Large fees or kickbacks promised to the mortgage broker<sup>2</sup>
- Making loans to mentally incapacitated homeowners
- Paying off low-rate mortgages<sup>3</sup>
- Shifting unsecured debt into mortgages<sup>4</sup>

---

1 These neighborhoods often include large numbers of senior and minority homeowners.

2 These fees should appear on the Good Faith Estimate and HUD-1 Settlement Statement. See discussion of these documents in §§ 3.4.2, 6.3.1, and 7.2.2 of this Handbook.

3 You will need to compare the terms of the loans that were refinanced with the new loan terms to determine if the deal was not in the borrower's interests.

4 Mortgage loans are marketed as a way to pay off credit cards and other unsecured debt by rolling several monthly payments into "one, easy" payment. By adding this debt into the mortgage loan, the lender can charge percentage-based fees on a higher principal amount, resulting in higher fees. Interest is also charged on a higher principal over the life of the loan which returns a higher amount of interest to the lender. Meanwhile, the homeowner has lost equity and is left with a higher monthly payment. Finally,

- Loans in excess of 100% loan-to-value (LTV)<sup>5</sup>

### 2.3.7.2 The Application

- Falsifying loan applications (particularly regarding income level)<sup>6</sup>
- Forged signatures
- Adding insincere co-signers

### 2.3.7.3 The Loan

- High interest rate (APR)
- High fees and closing costs<sup>7</sup>
- Balloon payments<sup>8</sup>
- Negative amortization<sup>9</sup>

---

it is almost never a good idea to transform shorter term, unsecured loans into long term debt. This places the home at greater risk of loss.

<sup>5</sup> LTV means loan-to-value. If a loan has an LTV of 100% or more, the homeowner can never refinance her way out of a bad loan. No reputable lender will touch a refinancing because there is no equity cushion in the event of a foreclosure. See discussion in § 2.3.3 above.

<sup>6</sup> Compare the homeowner's version of her monthly income to that which appears on the loan application. Brokers and loan officers who make subprime loans often make money based on a percentage of the loan. The bigger the loan, the more they make. Sometimes they "help" consumers by exaggerating or even falsifying extra income on their loan applications. A borrower whose income is falsified may get a larger loan, with a larger monthly payment than she can afford. Similarly, brokers and originators sometimes arrange to have friendly appraisers submit appraisals with inflated values.

See Paul D. Davies, *Inflated Values Enable Some Loans*, Phila. Daily News, April 23, 2001, at 6.

Inflated income results in loan underwriters approving a loan with a monthly payment that the consumer cannot afford. The resulting default and foreclosure obviously harms the homeowner victim. Inflated appraisals also harm the homeowner. Even though she may get a bigger loan, she will be unable to refinance later with any legitimate lender, because they will not lend in excess of the real fair market value. In this case the victim is trapped in a high-cost, predatory loan.

When confronted with inflated income or appraisals, lenders will often point the finger back at the homeowner and say: "you signed a loan application with this information, and we relied on what you told us." It is essential for advocates to expose the respective roles of the brokers, loan originator staff, closing agents and the consumer, to make clear that the false information is not being created by the borrower in most cases, but by the players who profit directly from this loan inflation process. At best, the consumer "ratifies" the false information only insofar as he or she signs an application, along with dozens of other documents at a loan closing.

<sup>7</sup> These charges are found on the Good Faith Estimate and HUD-1 Settlement Statement. See discussion of these documents in §§ 3.4.2, 6.3.1, and 7.2.2 of this Handbook. You need to become familiar with the ordinary and reasonable cost of a closing in your area. A friendly real estate attorney or closing agent can enlighten you and answer questions.

<sup>8</sup> Balloon payments are large payments which come due during a loan term, usually at the end of the term. They pose a problem for consumers because they rarely have the means to pay the full amount. Balloon payments are often coupled with a promise to refinance. Those refinancing promises are seldom met and foreclosure is a frequent consequence. A balloon payment will appear on the Truth In Lending disclosure (see the payment schedule) and in the loan note. See samples in Chapter 7.

<sup>9</sup> Negative amortization occurs when the payments due each period are insufficient to cover the interest on the loan as it comes due. The existence of a balloon payment suggests that the loan negatively amortizes. Using an amortization or APR computer program to determine the payment schedule should conclusively indicate if the monthly payments cover the interest that accrues each month. Two such

- High appraisal costs<sup>10</sup>
- Inflated appraisal<sup>11</sup>
- Padded recording fees<sup>12</sup>
- Back-dating of documents<sup>13</sup>
- Charging for duplicative services
- Requiring credit insurance<sup>14</sup>
- Mandatory arbitration clauses<sup>15</sup>
- Making an unaffordable loan based on the value of the property<sup>16</sup>

#### **2.3.7.4 The Closing**

- Rushed loan closing<sup>17</sup>
- Terms at closing different from what the borrowers thought they would get<sup>18</sup>

#### **2.3.7.5 After Closing**

---

programs appear on the CD-ROM accompanying National Consumer Law Center, Truth In Lending (4<sup>th</sup> ed. 1999 & Supp.).

10 Consult a real estate attorney or closing agent to decide if any particular fees are padded or inflated. All such fees are found on the Good Faith Estimate and HUD-1 Settlement Statement. See discussion of these documents in §§ 3.4.2, 6.3.1, and 7.2.2 of this Handbook.

11 This usually occurs when the borrower is purchasing a home and ties in with the “flipping” of property, i.e., the repeated sale and resale of property, usually by an investor. The appraiser, real estate agent, and lender are often in cahoots. The appraiser may receive a kickback from the real estate agent or lender. The real estate agent’s fee is a percentage of the sales price. Similarly, the lender charges “points” which are percentage-based fees. For both the real estate agent and the lender, the higher the sales price, the higher their fees.

12 You can contact your local deed records office and ask how much the fees are to record a mortgage, assignment, or other document. Certain taxes may be imposed as well. Sometimes, the lender’s charge for these items is higher than the actual cost which raises a red flag and possible legal claims. See Chapters 3 and 5.

13 A lender may backdate (put a date on the documents that is earlier in time than the actual date) to undermine the borrower’s right to cancel or the usefulness of other notices that must be provided before closing. Significant legal claims arise if this is done. See Chapters 3 and 5.

14 The purchase of credit insurance must be voluntary under state law with implications both under state law and Truth In Lending, if it is not. The homeowner will usually have signed a statement that proclaims that the insurance is voluntary. Look for this statement on the Truth In Lending disclosure. Do not stop there. Ask the homeowner what the lender said about the insurance and what the homeowner understood. See National Consumer Law Center, Cost of Credit: Regulation and Legal Challenges § 8.5.2 (2d ed. 2000 & Supp.).

15 The use of arbitration clauses in mortgage loan notes is becoming more widespread. There are a number of ways to attack these clauses. See the National Consumer Law Center, Consumer Arbitration Agreements: Enforceability and Other Topics (2001).

16 Compare the ability of the homeowner to make the monthly payments to the amount of equity in the home. You can determine the homeowner’s ability to repay by asking about monthly income and debt. Check this against the loan application to see if the information was accurate.

17 Try to walk your client through the loan closing to get a sense for how it was conducted and how long it took.

18 Compare the Good Faith Estimate, loan commitment letter, advertising, and other pre-closing documents with the HUD-1 settlement statement.

- Multiple refinancing or “flipping” of the mortgage loan (often after high-pressure sales)<sup>19</sup>
- Flipping in the sale and resale of the property<sup>20</sup>
- Excessive late fees (including daily interest)<sup>21</sup>
- Abusive collection practices<sup>22</sup>
- Excessive prepayment/repayment penalties<sup>23</sup>
- Incomplete or inadequate home improvement work

---

<sup>19</sup> Ask your client about previous loans, going back to the purchase money mortgage to make sure you haven't missed anything. Then collect as many of the documents for these earlier loans as possible.

<sup>20</sup> Flipping in this context means the repeated sale and resale of property, usually by investors. An investor may purchase the property cheap at a foreclosure, tax, or other sale and then sell high after misrepresenting the condition of the house or promising to make repairs and failing to do so. The appraiser, real estate agent, and lender may be co-conspirators. The appraiser may receive a kickback from the real estate agent or lender. The real estate agent's fee is a percentage of the sales price. Similarly, the lender charges “points” which are percentage-based fees. For both the real estate agent and the lender, the higher the sales price, the higher their fees. A check at the land records office or registry of deeds will reveal when and to whom title of each property has been transferred.

<sup>21</sup> Get a copy of the homeowner's payment history from the servicer or holder. This shows what charges were imposed, when payments were posted to the account, and how payments were attributed.

<sup>22</sup> Ask your client about the manner in which the payments have been collected. Review letters from the lender or servicer.

<sup>23</sup> Prepayment penalties are imposed via the loan note. They are charges imposed by the lender if the borrower pays off early by refinancing the loan. Some loans contain both a balloon payment and a prepayment penalty. The balloon payment drives the homeowner to refinance but the prepayment penalty makes it expensive to the borrower (and profitable to the current lender) to do so...a double whammy.