PHFA
PA HOUSING FINANCE AGENCY

DON'T GET HOOKED by PREDATORY LENDING

Making smart homebuying and home repair decisions

Tom Wolf, Governor • **Robin Wiessmann.,** Executive Director & CEO

PREDATORY LENDING

Predatory lending robs families of the equity in their homes, destroys neighborhoods by increasing foreclosures on properties, and prevents community renewal through deceptive business practices; it is a terrible blight on the Commonwealth. The Pennsylvania Housing Finance Agency is working to end it and hopes that the guidance this pamphlet provides will help consumers recognize and avoid predatory loan situations. Your knowledge and awareness are our greatest assets in this effort. Help us make Pennsylvania a better place to live.

Robin Wiessmann

PHFA Executive Director and CEO

WHAT IS PREDATORY LENDING?

Predatory lending is an unfair practice that takes advantage of borrowers' vulnerability and fears. It hurts homeowners by increasing their debts, impairing their ability to make payments on the loans, destroying the equity they may have in their houses, and damaging their credit.

This terrible practice is associated with mortgage loans for buying houses or making home repairs. Frequently it is directed against those least capable of making informed decisions: older adults, families with limited resources, minority homeowners, immigrants, borrowers with bad credit, and the infirm. It is bad for families and bad for the neighborhoods where they live. Predatory lending causes untold harm.

Predatory lending initially hides its true nature in appealing disguises that attract the very victims who should be most wary. Those who promote this menace say "yes" to borrowers' questions when the real answer should be a resounding "no." They can appear to be their victims' allies against hostile financial forces. Only later do the unsuspecting marks realize that their former friends have saddled them with debts they can never repay, for homes they can't afford, or for repairs that aren't made. For many, the awakening comes too late. Some never recover and those who do lose thousands of dollars.

Ignorance isn't bliss when it comes to predatory lending. The only way to avoid it is through knowledge. Although there are statutes designed to protect consumers against this corrosive practice, there is still no substitute for a little common sense and knowing what to look for in home mortgage or home repair loans. No less than the law of gravity, the laws of economics apply to everyone, **so if a deal sounds too good to be true, it is too good to be true**. "Let the buyer beware" was good advice when it was offered thousands of years ago, and it still holds true today.

This pamphlet offers general guidance about predatory lending. It is designed to provide basic knowledge, but it isn't comprehensive. Counseling agencies, local libraries, the Pennsylvania Department of Banking, the federal Office of the Controller of the Currency, lending institutions, credit unions, and the United States Department of Housing and Urban Development have a wealth of additional information about making smart homebuying and home repair decisions.

TYPICAL ELEMENTS OF PREDATORY LOANS

Predatory loans are infinitely variable, but there are certain elements that are typically found in them.

Exceedingly high interest rates: A loan interest rate that is much higher than the interest rate offered by "mainstream" lenders is a tip-off that a loan might be predatory. However, high rates are sometimes divulged to borrowers in a confusing manner to conceal their true impact.

Unusually high "points," fees, and other closing costs: Borrowers should be suspicious of lenders who charge fees that exceed seven or eight percent of the total loan amount.

Financing credit life insurance in loans: Loans requiring borrowers to finance credit life insurance as a condition of approval are likely to be predatory.

Mandatory arbitration clause favoring lenders: Loans containing provisions that disputes between borrowers and lenders be arbitrated by parties chosen by the lenders should be carefully considered, because this is often a sign that the loan is predatory.

Loans for much higher amounts than required: Lenders promising loans for much higher amounts than required should be approached warily by borrowers. This is a common predatory lending practice and the extra money is rarely seen; instead, it is eaten up with high fees and charges.

Refinancing lower-interest rate loans at higher rates: Borrowers who refinance lower-rate home mortgage loans at higher rates may fall victim to predatory lending.

Loans that offer no real benefit to homeowners: Senseless loans that provide nothing to homeowners should absolutely be avoided.

Loans that turn "unsecured" debts into "secured" mortgage debts: Refinancing unsecured debt (credit cards, "signature" loans, etc.) by securing them with a real estate mortgage must be approached carefully. Such "home equity loans" can easily be manipulated into predatory loans.

Prepayment penalties: Loans having "prepayment penalties" (extra charges for paying off the loan before its maturity date) should be

avoided. *Prepayment penalties are predatory* and indicate that there are likely to be other harmful loan features.

Inflated or fraudulent appraisals: Appraisals that are intentionally inflated to show a much higher home value than the property is worth are associated with predatory loans.

LOAN CONSIDERATIONS WHEN BUYING OR FIXING A HOUSE

Affordability: For most homebuyers, monthly mortgage payments shouldn't exceed about a third of their total income. Their mortgage payments plus any other installment debt shouldn't be much higher than 40 to 45 percent.

Fixed versus adjustable rates: If the loan interest rate is adjustable, homeowners should make sure they can afford the payments when the rate goes up.

Balloon payments: Many buyers are able to get into their homes by accepting loans that require low payments at first for a certain time but that become payable in full at the end of that period. This is called a "balloon payment" and may amount to more than the original cost of the house. Informed buyers should be aware of this before signing any loan agreements.

Home repair charges: Homeowners who need loans for repair work might want to shop around for loans before agreeing to anything. They may want to use a contracting firm they know and to make sure that the price quoted is in line with comparable work in the area. Companies quoting extremely high or promising unreasonably low costs should be given second (or third or fourth) thoughts.

PREDATORY LENDING BEHAVIOR

History has shown that those most likely to become victims of predatory lenders include older homeowners, low-income individuals, minority owners or homebuyers, and households without relationships with depository institutions such as banks or credit unions. Those who might fall into these categories should be especially wary of certain behavior by prospective lenders, such as:

- Being contacted by companies at home, without having requested a call.
- Being asked to sign blank forms that will be filled in later.
- Willingness of company representatives to falsify loan applications, particularly information about income.
- "High-pressure" sales presentations with "one-time" offers.
- Planning loan closings at places other than in lender offices (such as in the home, in a vehicle, at a restaurant, etc).
- Other names ("phantom" signers frequently unknown to borrowers) are added to documents to make loans seem more affordable.
- "Loan-to-value" ratio (how much is being borrowed compared to the value of the property) greater than 100 percent of the property's value.
- Changing loan terms at closing.
- Itemizing duplicate services then charging separately for them ("unbundling").
- Lending to persons with mental disabilities who do not understand the terms to which they agree.
- Forging important, key loan documents.

IMPORTANT MORTGAGE DOCUMENTS FOR BUYING OR IMPROVING RESIDENCES

Documents required by federal law, depending on the type of loan, are:

- Loan estimate (replaces the Good Faith Estimate and initial Truth-in-Lending disclosure)
- Closing disclosure (replaces the final Truth-in-Lending disclosure and HUD-1 Settlement statement)
- Notice of right to cancel (in certain mortgage loan transactions)
- Transfer of loan servicing statement
- Private mortgage insurance disclosure for loan consummated after July 1, 1999
- Controlled business arrangement disclosure (if applicable)
- Section 32 HOEPA notice (if HOEPA loan)

Documents required by Pennsylvania law, depending on type of loan, are:

- Loan note
- Mortgage
- Written broker agreements

Other important documents

- Cancelled checks from real estate transactions
- Copies of written agreements between home improvement contractors and lenders, mortgage brokers and lenders, lenders and any assignees, and lenders and trustees (if applicable)
- Residential loan applications
- Rate sheets provided by lenders and brokers
- Underwriting guidelines

A FINAL CONSIDERATION

"Flipping" of home loans is the repeated and senseless refinancing of mortgage loans. It is a practice common to predatory loan transactions and is used by the predator to strip the equity out of an owner's home. Borrowers should be extremely suspicious of schemes featuring frequent loan refinancing.

OTHER RESOURCES TO HELP PREVENT PREDATORY LENDING

Pennsylvania Department of Banking and Securities
17 North Second Street
Suite 1300
Harrisburg, PA 17101-2290
1.800.722.2657 | www.dobs.pa.gov

Pennsylvania Office of Attorney General
16th Floor
Strawberry Square
Harrisburg, PA 17120
1.800.441.2555 | www.attorneygeneral.gov

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