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CONCERNS
Information for Advocates
Representing Older Adults
National Consumer Law Center®

Helping Elderly Homeowners Victimized by Predatory Mortgage Loans

Equity-rich, cash poor, elderly homeowners are an attractive target for unscrupulous mortgage lenders. Many elderly homeowners are on fixed or limited incomes, yet need access to credit to pay for home repairs, medical care, property or municipal taxes, and other expenses. The equity they have amassed in their home may be their primary or only financial asset. Predatory lenders seek to capitalize on elders' need for cash by offering "easy" credit and loans packed with high interest rates, excessive fees and costs, credit insurance, balloon payments and other outrageous terms.

Deceptive lending practices, including those attributable to home improvement scams, are among the most frequent problems experienced by financially distressed elderly Americans seeking legal assistance. This is particularly true of minority homeowners who lack access to traditional banking services and rely disproportionately on finance companies and other less regulated lenders. But there are steps advocates can take to assist victims of predatory mortgage loans.

• A Few Examples

One 70 year old woman obtained a 15-year mortgage in the amount of $54,000 at a rate of 12.85%. Paying $596 a month, she will still be left with a final balloon payment of nearly $48,000 in 2011, when she will be 83 years old.

Another 68 year old woman took out a mortgage on her home in the amount of $20,334 in the early 1990s. Her loan was refinanced six times in as many years, bringing the final loan amount to nearly $55,000. She paid for credit life insurance all six times, with each premium exceeding $2,300.

The mortgage loan of a 72 year old man was refinanced three times in four years, twice by the same company. Over the course of the three refinancings, the loan amount doubled, from about $16,500 to $33,000. The final loan had an interest rate of 16.85%. Living on Social Security and unable to afford the monthly payments, he sought bankruptcy in an attempt to save his home.

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Why Predatory Lending and Foreclosures are on the Increase

Several factors have lead to the increase in predatory mortgage lending. Among them is the deregulation of the consumer credit industry in the 1980s which lead to the weakening of state regulatory and consumer protection statutes. A change of the tax code in 1986, which established a preference for second mortgage interest over interest on other consumer loans, led to aggressive marketing by lenders of the tax benefits of home equity loans. Consequently, many formerly unsecured obligations, such as medical bills and credit card debt, are now folded into higher-rate loans secured by homes even if the low-income consumer gets little or no tax benefit.

Another important factor is the increase in real estate property values from the 1990s through 2006. Some predatory mortgage brokers and lenders profit by making loans based solely on the value of the collateral, the equity in the home, rather than the homeowner's ability to repay the loan. When home values were rising, this practice was profitable because brokers and lenders could encourage homeowners to refinance the home multiple times, stripping-away the homeowner's equity by repeatedly charging excessive fees and commissions. Once the homeowner can no longer refinance or repay these high-rate, high-fee loans, the lender forecloses, purchases the home at auction, and resells it at a profit. This problem disproportionately affects the elderly, since they frequently have substantial equity built up over a long period of time and have little income to repay these loans.

Elderly homeowners who have sought legal assistance frequently say that they were unaware of the terms of the loan agreement they were signing. Often the terms of the loan are not fully explained to the elder. At other times, home improvement companies, who often act as brokers for many of these predatory mortgage loans, will use high pressure tactics or engage in other behavior to intentionally misrepresent or obscure the terms of the loan or its true cost. When elders get loans they cannot afford, they quickly fall behind and ultimately face foreclosure.

How to Identify Predatory Mortgage Loans

There are several "warning signs" that a loan may be abusive or predatory. While not all loans containing one or more of the following attributes are predatory loans, the features listed below are often associated with such loans.

- ## Misrepresentation or fraud in the solicitation, marketing or origination of the loan

For example, a lender may falsify a loan application to make it appear that an elderly applicant has enough income to qualify for a loan. Lenders or brokers may engage in this behavior to earn a quick profit from commissions and settlement fees on loans that are then sold to other financial institutions. Lenders may also engage in this behavior to profit from an elderly homeowner's equity by skimming it in the form of inflated settlement fees or when the unaffordable loan ultimately leads to foreclosure and the lender can purchase it.

- ## Home improvement scams

Home improvement contractors often steer elderly homeowners to predatory mortgage companies under the guise of arranging financing to pay for home improvements. The work is generally overpriced, and often incomplete or done in an extremely shoddy manner. The contractor may obtain a commission for acting as a broker on the loan. As local governments increasingly encourage the public to make their homes more energy efficient, homeowners and advocates should be alert to home improvement scams that purport to offer special government funding for weatherization.

- ## High Interest Rate

In many cases, the high interest rate cannot be justified by the risk and costs of providing credit to elderly homeowners. Predatory lenders often disguise the true costs of loans by using adjustable rate mortgages that start with an artificially low interest rate (called a "teaser rate") and monthly payments, that expire after a limited period ranging from 6 to 24 months. For elderly homeowners on fixed incomes, an increase in the monthly payment after the teaser expires can be devastating.

- ## High Closing Costs and Fees

Closing costs include points, broker's fees, document preparation fees, appraisal fees and attorney fees which are deducted from the proceeds of the loan. These fees may be much greater than the actual cost of the item or service provided, or duplicative of other itemized fees and costs.

- ## Balloon Payments

A balloon payment is a large lump sum of money due at the end of the term of the loan. Homeowners who cannot meet the balloon payment will lose their home to foreclosure unless they refinance the loan, often at an excessive cost.

- ## Excessive Prepayment Penalty

Lenders often impose excessive and unfair prepayment penalties to make even more profit if the homeowner attempts to refinance.

- ## Multiple Refinancing

This practice is also referred to as “flipping” or "churning." Lenders encourage homeowners (especially those with balloon payments) who need credit or who are in default to refinance their loan with the lender or an undisclosed affiliate of the lender. The new loan pays off the balance of the existing loan, including any prepayment penalty embedded in the old loan. The resulting loan has a higher principal balance and a new set of closing costs based on that higher balance. A loan may be refinanced several times in this manner. Each time the loan, is refinanced the lender charges a new set of closing costs which deplete the borrower's equity with little or no benefit to the elderly homeowner.

- ## Credit Insurance

Lenders will sell credit life insurance, credit accident and health insurance, or involuntary unemployment insurance, as part of the loan. This insurance is extremely profitable for the lender, as the lender often owns the insurance company, or receives a commission for the sale of the insurance. In addition, the insurance premium is often financed over the life of the loan which increases the total interest charged on the principal. Because it is profitable, credit insurance is often sold to individuals who will not benefit from it. Fortunately, due to changes in federal regulations, this practice has become much less common than it was.

- ## Negative Amortization

The lender structures the loan so the monthly payments look affordable but only because they do not cover the amount of interest accruing each month. As a result, the principal balance goes up each month rather than declining as the borrower expects. Most negatively amortizing loans require the borrower to begin making fully-amortizing payments after a certain number of years or when the balance reaches a certain percentage in excess of the original balance. This causes "payment shock" when the monthly payment due increases dramatically.

- ## Mortgage Broker Kickbacks

When a borrower uses a mortgage broker, the broker may charge a fee that is added to the closing costs. The broker, however, may also receive a separate fee from the lender (sometimes called a lender-paid commission or a yield spread premium) for referring the borrower to the lender or for having the homeowner sign a bigger loan, a loan with a higher rate, or one that is more profitable to the lender in some other way. The lender then passes the broker's fee on to the homeowner in the form of a higher interest payment over the loan term.

- ## Making loans the elderly homeowner cannot afford to repay.

These loans are made based solely on the amount of equity in a property, and are made to individuals who do not have the income to repay the loan. Elderly homeowners are particularly vulnerable to this practice because they have limited or fixed incomes and have substantial equity in their homes.

- ## Refinancing unsecured debt

Lenders encourage homeowners to finance or consolidate unsecured debt, such as credit cards or medical costs, into the mortgage loan. Homeowners are told it is a way to lower monthly payments and increase their tax deduction. Lenders do not mention that the higher home-secured debt burden increases the risk of foreclosure when the elder faces financial distress.

- ## No Escrow Account

Most lenders require an escrow account with first mortgages, however, some predatory lenders will refinance an existing loan that has an escrow account with a new loan that does not have one. Because the new total monthly payment does not include escrow, this gives the lender room to pack the loan with dubious fees and commissions, a higher interest rate, or room to refinance unsecured debts without making the borrower's total monthly payment appear noticeably larger than the payment on the old loan. The borrower may then risk a tax foreclosure or loss of homeowner's insurance if they do not make the formerly escrowed payments in addition to the loan payments.

Legal Challenges to Predatory Mortgage Loans

Elderly homeowners who have been victimized by predatory mortgage lenders have a number of legal options. What follows is a brief summary of some legal options advocates can use to challenge abusive mortgage lending. These claims are complex; please consult the additional resources listed at the end of this Consumer Concern.

• The Truth in Lending Act (TILA)

Under the Truth in Lending Act[1] lenders must disclose important details regarding the cost and terms of a loan. TILA gives homeowners the right to rescind a non-purchase money loan secured by his or her primary residence. This includes manufactured homes, home equity loans and home improvement loans, whether first or second mortgages, so long as the proceeds of the loan were not used to purchase the home. The homeowner must be provided with written notice of this right to cancel. The homeowner may cancel the loan for any reason up to three business days (including Saturdays) after the transaction. The right to cancel is extended for up to three years if the lender did not make the disclosures properly or did not give the homeowner the required material disclosures, including notice of the right to rescind. The National Consumer Law Center's Truth in Lending manual provides detailed information on how TILA can be used to challenge predatory loans.

• Home Ownership and Equity Protection Act (HOEPA)

The Home Ownership and Equity Protection Act (HOEPA), an amendment to TILA, covers certain high rate, non-purchase money, home loans.[2] In addition to notice of the right to cancel and other disclosures required by TILA, if a loan is covered under HOEPA, lenders must provide borrowers with additional disclosures of the principal amount of the loan, the APR and the monthly payment three days prior to closing. If there is a balloon payment at the end of the mortgage the amount of the balloon payment must be disclosed. Also, for variable rate mortgages, the highest possible monthly mortgage payment must be disclosed. These disclosures must also include provisions telling the borrower that they are not required to sign the loan agreement simply because they received the disclosure statements, and they may lose their home if they do not meet their obligations under the terms of the loan.

In addition to the disclosure requirements, HOEPA prohibits the inclusion of certain terms in the loan contract. A loan covered under HOEPA may not include the following: a term which increases the interest rate in the event of default; balloon payments in loans of less than five years; negative amortization; more than two prepaid payments; extending credit to individuals without regard to their ability to repay the loan; most due-on demand clauses; and disbursement of funds payable solely to a home improvement contractor instead of jointly or solely to the consumer. Most prepayment penalties are also prohibited.

Violations of HOEPA's disclosure provisions and inclusion of prohibited contract terms will give rise to civil liability for actual damages, statutory damages, and attorney fees and costs. In addition, there are special enhanced damages for material violations. Most HOEPA violations give rise to TILA's extended right to rescind. HOEPA also makes assignees of covered loans liable for all claims and defenses that the consumer could assert against the loan originator, with respect to the assigned mortgage and subject to certain limitations on damages.

By 2006 most lenders claimed to have ceased making loans that had interest rate or points and fees high enough to qualify as HOEPA loans. However, a loan that on the surface appears to be below the HOEPA triggers may actually be a HOEPA loan once the lender's characterization of various loan charges is scrutinized. If it is not a HOEPA loan but the annual percentage rate is, nevertheless, higher than the rate for prime loans, it may be a Higher-Priced Mortgage Loan.[1]

• Higher-Priced Mortgage Loans (HPMLs)

Higher-priced mortgage loans have annual percentage rates similar to those commonly associated with subprime loans. These rates are higher than prime loans but lower than HOEPA loans. HPMLs are identified only by the APR; there is no points-and-fees trigger. HPMLs are subject to similar, but less stringent, requirements as HOEPA loans. Creditors may not make a HPML without first evaluating the consumer's ability to pay using the same standards as for HOEPA loans. HPMLs may not include prepayment penalties unless the terms meet certain conditions. The loan must include an escrow account, and the loan may not be structured as an open-end line of credit to evade the HPML protections. The remedies for violations are similar to those for HOEPA but only the limit on prepayment penalties can create a right to rescind.

• Real Estate Settlement and Procedures Act (RESPA)

Among other provisions, the Real Estate Settlement and Procedures Act (RESPA)[3] prohibits the payments of unearned fees and kickbacks. A lender kickback to a mortgage broker for making a referral is forbidden. The remedy for violation of this provision is treble damages and attorney fees.

• State Unfair and Deceptive Acts and Practices Laws

Many of the abusive practices and loan terms found in predatory mortgage loans can be challenged under state unfair and deceptive acts and practices (UDAP) laws.[4] If a state's UDAP statute covers the type of transaction or the creditor involved, advocates may bring claims for practices such as repeated and unnecessary refinancing ("flipping") of loans, making unaffordable loans to consumers to acquire the equity in the property, or misrepresenting the loan terms. Excessive fees and costs, and other terms that are disadvantageous to the borrower may be challenged as well.

• Other Laws

Warranty law, usury, unconscionability, breach of fiduciary duty, fraud, and contract law have remedies which may prove helpful in challenging abusive loans. Some states have laws that regulate predatory home loans.[5] Other laws, including the Equal Credit Opportunity Act and the Fair Housing Act, have also been used to challenge these practices.

[1] Regulation Z (12 C.F.R.) § 226.35. The Higher-Priced Mortgage Regulations took effect October 1, 2009. For a discussion of HPMLs, *see* National Consumer Law Center, Truth in Lending, Ch. 9 (2009 Supp.).

For More Information

Several manuals published by the National Consumer Law Center will be helpful for advocates challenging these practices.

- Stop Predatory Lending: A Guide for Legal Advocates
- Truth in Lending
- The Cost of Credit
- Repossessions
- Foreclosures
- Unfair and Deceptive Acts and Practices
- Consumer Bankruptcy Law and Practice

In addition, several other organizations involved in predatory lending issues have additional information on the subject.

American Association of Retired Persons (AARP), Consumer Affairs Division, 601 E. Street, N.W., Washington, D.C. 20410, 1-888-687-2277 or http://www.aarp.org

Federal Trade Commission, Office of Consumer/Business Education, 7373 147th St. N.W. Washington, D.C. 20580. The FTC has a number of useful publications on mortgage and real estate issues http://www.ftc.gov/bcp/menus/consumer/credit/mortgage.shtm or call 1-877-FTC-HELP.

1. 15 U.S.C. §§ 1601 *et seq*. For more information, *see generally* National Consumer Law Center, Truth in Lending (6th ed. 2007 and Supp.).

2. 15 U.S.C. § 1639. The effective date of HOEPA was October 1, 1995. For a discussion of HOEPA, *see* National Consumer Law Center, Truth in Lending, Ch. 9 (5th ed. 2007 and Supp.).

3. 12 U.S.C. §§ 2601 *et seq*. *See generally* National Consumer Law Center, The Cost of Credit: Regulation, Preemption, and Industry Abuses, § 12.2 (4th ed. 2009).

4. *See generally* National Consumer Law Center, Unfair and Deceptive Acts and Practices (7th ed. 2008).

5. *See generally* National Consumer Law Center, Cost of Credit, Appx. A (4th ed. 2009).

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