Avoiding Predatory Lending

Protect Yourself in the Loan Process
Don't fall prey to predatory lending!

If you are in the market for a new loan to purchase real property or a loan to refinance an existing mortgage, the mortgage market place offers numerous types of loan products. Being knowledgeable about the loan process will help you find the most desirable loan product and avoid the pitfalls of predatory lending.

About Predatory Lending

The term "predatory lending" encompasses a variety of home mortgage lending practices. Predatory lenders often try to pressure consumers into signing loan agreements they cannot afford or simply are not in the consumers' best interest. Often, through the use of false promises and deceptive sales tactics, borrowers are convinced to sign a loan contract before they have had a chance to review the paperwork and do the math to determine whether they can truly afford the loan.

Predatory loans carry high up-front fees that are added to the balance, decreasing the homeowner's equity. Loan amounts are usually based on the borrower's home equity without consideration of the borrower's ability to make the scheduled payments. When borrowers have trouble repaying the debt, they are often encouraged to refinance the loan into another unaffordable, high-fee loan that rarely provides economic benefit to the consumer. This cycle of high-cost loan refinancing can ultimately deplete the homeowner's equity and result in foreclosure.

Predatory lending practices specifically prohibited by law include:

- **Flipping** - the frequent making of new loans to refinance existing loans,
- **Packing** - the selling of additional products without the borrower's informed consent, and
- **Charging excessive fees.**

Homeowners in certain communities, particularly the elderly and minorities, are especially likely to be targets of predatory lending but almost anyone can fall prey to abusive lending practices. You can protect yourself by knowing what you can afford; choosing a reputable, licensed broker/lender; understanding the loan application and contract; and being aware of commonly-used predatory lending tactics. **Informed decision-making is your best defense!**

Know What You Can Afford

- **DO** manage your money wisely, as your credit history is your responsibility.
- **DO** carefully review your income and expenses and ALWAYS borrow within your budget!

- **DO NOT** inflate your earnings or provide false information to qualify for a loan as the lender's borrower qualifications are based on what an individual or family must earn to afford the mortgage payment.
- **DO NOT** bet on future income increases as there are no certainties in the future, but it is a certainty that you could face the loss of your home and all of the money you paid on the loan if you can't make the payments due to unforeseen events.

Choose a Reputable, Licensed Broker/Lender

- A good way to find a reputable broker and/or lender is to ask family members and/or friends who will not gain personally to refer you to brokers and/or lenders they have used satisfactorily.
- Be aware of salespersons who approach you with offers that sound too good to be true.
- Prior to using the services of a mortgage broker or lender, make sure they are properly licensed by checking with the California Department of Corporations and/or the California Department of Real Estate.

Applying for a Loan

- There are oftentimes major differences between various lending sources, so shop around for the best loan and visit several reputable mortgage brokers and lenders.
- Compare interest rates, fees and points and examine all of the terms of the loan.
- The law requires mortgage brokers and lenders to notify you of your right to review your credit score and the key factors affecting your credit score. Obtain a copy of your credit report to verify that it accurately reflects your credit history.
- In most mortgage loan transactions, you are entitled by state and federal law to a "Good Faith Estimate" disclosure of the costs and expenses you are expected to pay in connection with obtaining the loan. Read it carefully and question any items you don't understand.
- Double-check the loan application for accuracy in the cost of the home, your income and your employment information. If false information is provided, you could lose your home if the lender decides to foreclose and/or even face criminal charges.

Before You Sign

- Ask questions about the terms of the loan and check the contract to confirm that the terms you agreed upon are clearly written in the loan documents.
- Read the entire loan contract to make sure you fully understand your obligations and all provisions of the contract before signing. **NEVER** sign blank forms or sign one with information that is incorrect.
- Talk with a knowledgeable and trusted advisor or professional of your choice prior to signing a loan agreement. **NEVER ALLOW YOURSELF** to be pressured to sign a contract that you are not comfortable with or do not understand. **NEVER RELY** on verbal assurances that are not in writing.

- Find out if you have cancellation rights. Some loans, but not all, give you the right to cancel the loan application within three days after signing. Carefully review your loan application to determine whether or not you have cancellation rights.

Beware of these Predatory Lending Tactics

- Exceedingly high interest rates and inflated fees in comparison with other lenders.
- Bait and switch tactics where a mortgage broker or lender knowingly offers one set of terms which are more appealing but are not readily available and then pressures the borrower into signing a contract with more expensive terms and hidden fees.
- Door-to-door high pressure salespersons and pitches for home equity loans related to home improvement contracts or contracts for the installation of items such as drapes and carpets.
- Salespersons with backgrounds similar to yours who attempt to gain your trust. This tactic is oftentimes used to lull a homeowner into a false sense of security, causing the homeowner to make a decision based on trust instead of knowledge and understanding.
- Mail, radio and television ads that claim "No job! No credit! No problem! You can still qualify for a loan based on your home equity." These ads encourage you to place your home at risk. If you can't make the payments, you will lose your home! Offers that sound too good to be true, usually are.
- High-pressure sales tactics requiring you to sign a loan contract right away. If the offer is good today, it should probably be good tomorrow, **AFTER** you have reviewed the contract and have consulted a knowledgeable, uninvolved advisor.

High Rate/High Fee Loans

As of July 1, 2002, California has a law covering "high rate/high fee" loans. The law contains special rules regarding balloon payments, prepayment penalties, the borrower's ability to repay the loan, and many others. It also requires that the loan have a tangible benefit to the consumer. With certain specified exceptions, a "covered loan" is a consumer credit transaction (primarily for personal, family or household purposes) that is secured by a one to four unit dwelling that is or intended to be the borrower's principal residence; the annual percentage rate (APR) exceeds by 8 points or more the yield on Treasury Securities having a similar term, or the total points and fees, as defined, payable by the consumer at or before closing will exceed 6 percent of the total loan amount. The maximum amount covered is the most current FannieMae single-family first mortgage conforming loan limit.

Open end credit transactions, sometimes known as "home-equity lines of credit" (HELOCs) are not covered by this law. Be wary of a broker who attempts to steer you into obtaining a HELOC if it was not your intention to obtain one as he or she may be attempting to evade this law. A broker has a responsibility to you as your agent to discuss all possible loan options with you and inform you of the advantages and disadvantages of each. You should not be pressured or steered into a loan that is not suitable for your needs or ability to pay.

As of July 1, 2010, California also has a law covering higher-priced mortgage loans. The law contains special rules regarding prepayment penalty and the borrower's ability to repay the loan.

A higher-priced mortgage is a first lien on a principal dwelling in which the APR exceeds the average rate by 1.5 percent or more or is a junior lien on a principal dwelling in which the APR exceeds the average rate by 3.5 percent or more.

Further Information

Using the Services of a Mortgage Broker, published by the California Department of Real Estate, provides further information about the various aspects of mortgage transactions including the mortgage broker's role, acceptable commissions and fees, definitions of terms, tools for decision-making, your rights, what to expect and where to go for help.

Mortgage Borrower's Rights, published by the U.S. Department of Housing and Urban Development, lists rights you have and should be aware of before you enter into any loan agreement.