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DEFINING PREDATORY MORTGAGE LENDING IN UTAH:

A PROFESSIONAL'S PERSPECTIVE

by

Luke V. Erickson

A thesis submitted in partial fulfillment
of the requirements for the degree

of

MASTER OF SCIENCE

in

Family, Consumer, and Human Development

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ABSTRACT

Defining Predatory Mortgage Lending in Utah:

A Professional Perspective

by

Luke V. Erickson, Master of Science

Utah State University, 2006

Major Professor: Dr. Lucy Delgadillo
Department: Family, Consumer, and Human Development

The purpose of this study was to define and describe the nature of predatory mortgage lending in the state of Utah. Twelve professionals from the state who work in the mortgage lending market participated. Data consisted of interviewee comments and were analyzed qualitatively using a multi-step method of coding for concepts and themes.

Through coding and analysis it was determined that the term predatory mortgage lending is defined as an act of abuse that is targeted towards a borrower with one or more vulnerable characteristics. It was also found that users of this term do not always adhere to this strict definition, but rather use it as a catch-all term for any general mortgage abuse, rather than only for those that are targeted. The term is also used when referring to instances of fraud, and nearly all other forms of unfair lending.

To help increase the measurability of predatory lending, the interviews also gave descriptive detail in terms of its magnitude, underlying factors, commonly occurring practices, victim characteristics, impacts, and suggestions for reduction. Suggestions for

reduction of predatory lending include increasing accountability of actors, both legally and by the industry itself, bridging state and national jurisdictional gaps, and increasing funding for consumer education and neighborhood revitalization. Education was especially emphasized as a tool for preventing occurrences of predatory mortgage lending, not only in the form of pre-homebuyer education but especially in the form of financial education as a requirement in the public schools, beginning at a very young age.

(134 pages)

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Sincere thanks also to my friends, siblings, and parents for all you have taught. I wish to especially thank my bride, Rachel, for all that she does, has done, and for all the work ahead of her, and, of course, for her spontaneity.

Luke V. Erickson

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CHAPTER I

INTRODUCTION

Problem Statement

The Mortgage Bankers Association estimated that $2.5 trillion in mortgage loans would be made during 2005 (Federal Bureau of Investigation, 2005). Because of their sheer size, the mortgage lending and the housing markets have a significant impact on the nation's overall economy (Federal Bureau of Investigation). With nearly 70% of Americans owning homes and the majority of those spending between 25-50% of their incomes on housing, it is easy to see why the market is so vast (Colton, 2003).

In an effort by the federal government to improve affordability, the mortgage lending market has been deregulated over the last several decades (Engel & McCoy, 2002). Because of increased freedom to lend without government imposed caps on interest rates and fees, and the ability to trade bundles of securitized loans on the market and to quickly estimate a borrower's credit risk, lenders have become far more willing than in the past to lend large amounts of money to very risky borrowers (Engel & McCoy). Thus nearly anyone can secure a loan at some price (Engel & McCoy). This riskier section of the mortgage lending market has been labeled subprime lending.

The subprime lending market has existed for decades, but it exploded in the early 1990s, growing from an estimated $35 billion in 1994 to $220 billion in 2002 (Federal Reserve Bank of Chicago, 2003; Lord, 2005; U.S. Department of Housing, 2000). From 1993 to 1998 the numbers of loans made by lenders specializing in subprime loans grew nearly 10 times from 104,000 to 997,000 (Lord; U.S. Department of Housing).

Securitization of subprime loans grew from $11 billion in 1994 to $203 billion in 2003; the nearly 20-fold increase demonstrating a continued and widespread acceptance of investment in high risk loans (Lord).

Not all of the growth has been positive, however. Between the years 1990 to 1998 foreclosures grew 384% (U.S. Census Bureau, 1999). In 1993, subprime lending and services accounted for 1.4% of the foreclosures, but in 1998, 35.7% of foreclosures were subprime and this percentage is expected to increase (National Training and Information Center, 1999). The news headlines also became riddled with accounts of unethical and unscrupulous lenders who were making profits at the expense of unsuspecting borrowers; an epidemic dubbed "predatory lending" (McCoy & Wyly, 2004).

According to McCoy and Wyly (2004), from 1992 to 1999 the average number of articles in major U.S. newspapers with "predatory" and "mortgage" in the headline, lead paragraph, or subject terms, was about 20 per year, while the average number of articles fitting the same criteria from 2000-2003 was roughly 200 per year, or ten times higher. Using conservative figures, Stein (2001) estimated that direct annual losses to U.S. consumers from predatory lending practices were at a minimum, $9.1 billion. This conservative figure does not include any losses to individuals or neighborhoods because of excessive foreclosures, nor does it include the more subtle predatory lending practices, which are ever increasing (Stein).

According to a HUD/Treasury joint report (U.S. Department of Housing, 2000), these types of loans do indeed increase foreclosure rates, and increase the financial burdens of homeowners, which often results in their bankruptcy (Sullivan, Warren, &

Westbrook, 2000). By their very nature, predatory loans decrease the financial stability of a household; bleeding already vulnerable households of their low-incomes and savings (Cordy, 2003; Special Committee on Aging, 2004). Differences between legitimate subprime and predatory loans can be slight, but have significant consequences (U.S. Department of Housing). An adequate separation between legitimate subprime lending and illegitimate predatory lending is necessary in order to reduce the losses to financially vulnerable households.

Need for Study

The HUD/Treasury report (U.S. Department of Housing, 2000) conveyed the idea that defining predatory mortgage lending is a problematic task because bad actors[1] are constantly developing new and abusive lending practices, often with a specific intent to avoid new government regulations (U.S. Department of Housing). Additionally, predatory lending cannot be confined to a list of unethical actions on the part of the lender because predatory loans are also functions of how and to whom they are made. For example, a prepayment penalty may be ethical in a case in which a borrower agrees to its terms in order to reduce his interest rate; however, a lender who includes a prepayment penalty without the knowledge or consent of the borrower, and does not provide a benefit in return such as a reduced interest rate, is unethical. Another reason that lists of predatory acts are insufficient is because a loan can often be legitimate while containing one of the named acts, but only when that act is combined with another act or

[1] The term "bad actor" was used by the U.S. Department of Treasury (2000) and other literature to describe all perpetrators in bad loans, not just lenders. This could include appraisers, brokers, loan officers, real estate agents, and any other party that acts as a perpetrator of predatory lending actions.

circumstance is the loan truly predatory (U.S. Department of Housing). In an effort to produce an encompassing definition, the 2000 HUD/Treasury joint report defined predatory lending as follows:

> [Predatory lending] involves engaging in deception or fraud, manipulating the borrower through aggressive sales tactics, or taking unfair advantage of a borrower's lack of understanding about loan terms. These practices are often combined with loan terms that, alone or in combination, are abusive or make the borrower more vulnerable to abusive practices. (p.1)

While this definition is encompassing, its generality allows for little enforceability. Who is to decide when deception, manipulation, aggression and unfair sales tactics occur, and by what standards? Again, this definition has only led to a need for further definitions before effective steps can be made. It should be no surprise that most attempts to address and regulate predatory lending have been rebutted with the argument that no one can agree upon a clear and concise definition (Engel & McCoy, 2002).

Opponents of predatory lending reform argue that because the problem is not clearly definable, a clear solution is neither needed nor achievable. Advocates of reform argue that, "because you know it when you see it," something should obviously be done. The Truth in Lending Act (TILA) was one federal attempt to address unfair lending issues (Engel & McCoy, 2002). This legislation requires lenders to clearly disclose finance charges, the principle amount borrowed, the total interest to be paid over the life of the loan, and the Annual Percentage Rate (APR)[2] (Lord, 2005). TILA also allows a borrower of a home equity loan, or a refinancing, three days to cancel the loan without

---

[2] Annual Percentage Rate (APR) is defined as the "Annual cost of credit over the life of a loan, including interest, service charges, points, loan fees, mortgage insurance, and other items (Monarch Homes, 2005)."

any penalties (Lord). The Real Estate Settlement Procedures Act (RESPA) requires lenders to clearly disclose fees, and supply a Good Faith Estimate, to reasonably assess the true costs of a loan. The Home Ownership Equity Protection Act (HOEPA) passed by Congress in 1994 is designed to offer protections to borrowers who enter high cost loans, which are defined by interest rates that are 8 percent higher than Treasury Security rates (Senate Committee on Banking, 2001). Because of loose definitions, weak penalties, and the ability of lenders to adapt and work around them, very little protection has actually been provided by these regulations, and they have not significantly reduced the abuses faced by many low-income, minority and elderly homeowners (Lord, 2005; Senate Committee on Banking). Every year since 1999 has seen new state regulation efforts to address predatory lending, though many of these efforts consist of very loose and ineffective statutes (Engel & McCoy). To complicate the matter, turf battles rage between state and federal regulatory agencies over who has jurisdiction over certain lenders and geographical areas (Lord; U.S. Department of Housing, 2000).

Purpose of Study

Utah possesses at least three alarming indicators of financial trouble: (1) The state ranks number three out of all 50 states for bankruptcy per household (American Bankruptcy Institute, 2004); (2) It ranks in the top ten for foreclosures (Mitchell, 2003); and (3) It ranks in the top ten for instances of mortgage fraud (Federal Bureau of Investigation, 2005). In addition to these strong financial indicators, a formal estimation by Stein (2001) concluded that Utah consumers were victims of $91 million worth of predatory lending scams in 2000, with increasing losses expected in subsequent years.

Predatory mortgage lending is indeed a serious and escalating problem, specifically for Utah, but because there is no agreed upon definition of predatory lending it is very difficult to track and regulate.

The purpose of this study was to assess the nature of abusive and high-cost (predatory) loans in Utah. Because mortgage lending professionals have the most frequent interactions with mortgage lenders and borrowers than any other group in the state, they are considered the foremost experts on the matter, and are therefore the focus or sample of this study. Predatory mortgage lending will be examined in the context of mortgage lending professionals' experiences, perspectives, and expert opinions.

Objectives

Each of the following objectives will be measured according to the perceptions and perspectives of the twelve full-time mortgage market participants:

1. Conceptualize a definition of predatory mortgage lending.
2. Determine the extent or magnitude of predatory loans in Utah.
3. Identify the common characteristics of the victims of these loans.
4. Identify the major factors behind the existence of high cost and abusive home loans.
5. Document specific predatory practices seen in home loans.
6. Determine optimal strategies for reducing predatory mortgage lending in Utah.

Contributions of the Study

The results of this study offer a unique definition of predatory mortgage lending in Utah by more extensively defining the problem so that regulation and education might consequently be more effective.

Increased awareness of the nature of unscrupulous lending can lead to further consumer education and responsiveness, thus significantly reducing the $91 million figure currently lost by Utah borrowers each year (Stein, 2001). As this market inefficiency is remedied, market forces will drive predatory lenders out of business while increasing the success of legitimate lenders. Society as a whole will then benefit through a decrease in foreclosures in neighborhoods, increased equity in the homes of borrowers, and increased homeownership rates.

The succeeding chapter is a review of relevant literature and sources that offers a further description of the mortgage lending market. Differences and similarities between the prime, subprime and predatory markets, and a comparison to mortgage fraud are emphasized. A general discussion of borrower and lender characteristics is presented, and the chapter concludes with a description of some of the predatory practices that have been identified in previous research.

CHAPTER II

LITERATURE REVIEW

Historical Factors

The 1949 Housing Act set in place the tools needed for many to realize the American dream of ownership of quality homes. Today, this dream has been achieved by many Americans and the issues facing today's prospective buyers seems to no longer be the ability to find quality housing, but the affordability of these houses (Colton, 2003).

Deregulation of the mortgage lending market was one answer to the problem of affordability (Engel & McCoy, 2002). Due to increased freedom to lend without government imposed caps on interest rates and fees, and the ability to trade bundles of securitized loans on the market and to quickly estimate a borrower's credit risk, lenders have become far more willing to lend large amounts of money to very risky borrowers (Engel & McCoy). Thus nearly anyone can secure a loan at some price, though that price may be astronomical (Engel & McCoy). And thus follows what some have called the mortgage lending crisis.

Causes of the Mortgage Crisis

Rises in consumer credit card debt and the introduction of the 1986 Tax Reform Law created an incentive for many to seek debt consolidation plans through subprime lenders in order to take advantage of the tax deductibility of home loan interest (Lord, 2005; Senate Committee on Banking, 2001). This encouraged consumers to convert unsecured debt in to secured debt which is backed by their own homes (Lord; Senate

Committee on Banking). Additionally, each refinancing or consolidation strips equity from one's home because of the borrowing against equity, but more importantly, because of excessive fees that often do not benefit the borrower in any way. A person delinquent on a consolidated home loan will see their home on the auction block after missing only several payments, and little opportunity for negotiation (Lord).

The alternative to home loan debt consolidation, however, is retention of unsecured debt. Those with large unsecured debts who choose not to consolidate face collection harassment and high rates of bankruptcy, leaving them with impaired credit scores and little opportunity for prime rates in the future (Lord, 2005). Though many would say that consumers have brought these debt traps upon themselves, it is clear that these two scenarios leave little room for consumer optimism today.

Increasing Real Estate Values

The values of real estate in the country increased substantially through the 90s, having a particular impact on low and moderate income homeowners. The expanded home equity made it possible for many to borrow extensively against their homes, and encouraged lenders to loan based on equity and not monthly affordability (Senate Committee on Banking, 2001). Asset based loans are the main course of predatory lenders because it allows the lender to earn immediate profits through equity stripping in addition to the usual overpriced monthly payments, making these loans extremely lucrative (Sturdevent & Brennan, 1999). The more times the lender can refinance the same customer, the more fees they strip from the home's equity.

Mortgage Broker Proliferation

Growing from 100,000 to over 1 million from 1993 to 1999, the number of homes brokered in the subprime market has exploded (Center for Policy Alternatives, 2005). An Association for the Advancement of Retired Persons (AARP) research report (Kim-Sung & Hermanson, 2003) found that brokers are involved in over half of all home loan closings, with a steadily rising number each year. Brokers have been known to play a large role in predatory lending practices due to conflicting incentives. Brokers are encouraged to find the best loans for consumers, yet at the same time they are often paid more for signing up consumers with more expensive loans (Kim-Sung & Hermanson). Additionally, the brokers have no incentive to ensure long-term stability of loans because they do not hold loans through maturity (Kim-Sung & Hermanson). In short, brokers are often confronted with an array of conflicting motivations.

Three Mortgage Markets

Only through a discussion of the separate mortgage markets and practices in each market can predatory lending be understood in an appropriate context. Relevant literature gives an illustration of predatory lending, and how it evolved from previous mortgage lending market conditions.

Prime Market

The prime market offers traditional loans to low-risk borrowers (Engel & McCoy, 2002). Compared to subprime and predatory loans, these loans are relatively straightforward, and simple to understand, and include only minimal fees, which are

usually quite small. Prime market customers are usually better educated and have better resources available to them for understanding the terms of loans than subprime customers.

Subprime Market

In the 1980's banks began widely using a tool generally known as "asset-backed securities" to realize profits more rapidly (Lord, 2005). Loans were bundled together in groups of hundreds or thousands, and sold on the stock market as mortgage backed securities (Lord). Even foreclosure did not pose risk of loss to security investors because the loss from each foreclosure was absorbed by the thousands of other loans included in the security, was protected by the homeowners own equity, and was further shielded through overpriced credit insurance (Lord; Senate Committee on Banking, 2001).

The relatively safe investment opportunities were sold at slightly lower rates on Wall Street than the borrowers were paying. The difference became millions of dollars of nearly instant profits to the lenders (Lord, 2005). With operating costs covered and profits skimmed off, the bulk of the billion dollar transactions could be funneled right back into pools for lending to homebuyers. The lending industry's liquidity of billions had been increased through the securitization of loans in the secondary market, making available unprecedented levels of cash for lending (Senate Committee on Banking, 2001). Meanwhile, the ability to quickly convert high-rate, high-risk loans into nearly instant profits has turned even the riskiest borrowers into potential gold mines (Lord, 2005). And thus, widespread subprime lending was born.

Most subprime lenders are nonbank institutions or bank subsidiaries (Engel & McCoy, 2002). Legitimate subprime lenders tailor their loans to those borrowers deemed riskier because of short or tarnished credit histories (Engel & McCoy). Smith and Immergluck (2004) found that the foreclosure rate in the subprime market is 20 times higher than in the prime market, reflecting at least in part the increased riskiness of the market and need for increased costs (Engel & McCoy). To hedge against the increased risk of these loans, subprime lenders generally charge higher rates than prime lenders, but the charges closely reflect the credit risk of each particular borrower (Engel and McCoy).

Predatory Market

Though redlining is now illegal, banks continue to shy away from serving low-income, minority, single women, and elderly households, and instead set up subprime branches or subsidiaries to serve them (Lord, 2005). Nondepository institutions which are not associated with banks also build stores in these areas. Though these subprime branches are supposed to cover the basic lending needs in these areas, Engel and McCoy (2001) reported that many borrowers never approach a lending institution of any kind because they believe they lack necessary credentials for a loan. Predatory lenders can therefore actively solicit these neighborhoods with little or no competition from legitimate lenders, in spite of exorbitant prices. Combine the lack of competition with borrower naivety and a prime target area for predatory loans is found. Predatory lending is of course not limited only to areas fitting this description, but according to many reports, pockets of rampant predatory lending often occur in them (Engel & McCoy).

In the sense that most victims of predatory loans are low-income, minority, elderly, single female and have poor credit, the problem of predatory lending is primarily a subprime market phenomenon (Engel & McCoy, 2002). Predatory lenders target individuals who are naïve, or not particularly financially savvy, and lack connections to the prime market (Engel & McCoy). Deception, unethical procedures, and hard sell tactics are used to trick and trap these borrowers into loans with high fees and rates, which disproportionately benefit the lender, and harm the borrower (Engel & McCoy).

It is not necessary, however, that a loan be subprime in order to be predatory. Sometimes obscure cases of predatory lending occur in the prime market, though the vast majority of predatory lending occurs in the realm of the subprime market (Engel & McCoy, 2002). Figure 1 depicts the relationship of predatory lending among the prime and subprime markets, and also introduces the concept of mortgage fraud which is subsequently discussed. Figure 1 does not represent accurate market sizes but is meant only to represent the overlapping characteristics of these markets.

While prime and subprime transactions generally offer mutual benefit to the lenders and the buyers, predatory loans offer disproportionate benefit to the lenders and harm to the borrowers (Engel & McCoy, 2002). In a very general sense any lender can be a predatory lender simply by adding excessive fees and interest rates to an otherwise mutually beneficial loan, or by excessively or deceitfully pushing a loan or loan products on a customer. The exact definitions of excess and deceit, however, have become the real roadblock in affecting regulation, particularly in the subprime market.

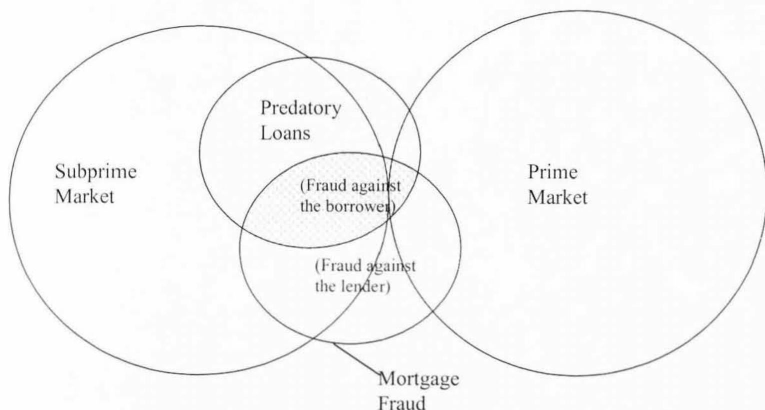

Figure 1. Overlapping markets.

It is agreed that subprime lenders fill a particular niche in the lending industry. They agree to lend to riskier individuals as long as they are allowed tier price, or to charge each borrower according to his/her riskiness. This can effectively alter the cost of the very same loan by thousands of dollars, depending on the individual. The real difficulty in the subprime market is determining when a lender is simply charging rates to cover potential losses, or excessively charging a customer, thus turning the loan into a predatory one. According to the 2000 HUD/Treasury report, the differences can be slight, but disastrous (U.S. Department of Housing, 2000).

Predatory lending may involve mortgage fraud schemes that contain some type of material misstatement, misrepresentation, or omission relied upon by an underwriter, lender or borrower, to fund, insure, or purchase a loan (Federal Bureau of Investigation, 2005). Perpetrators of mortgage fraud are either "fraud for profit" insiders, or "fraud for

housing" borrowers (Federal Bureau of Investigation). Fraud-for-housing cases involve a borrower deliberately misstating income, employment, or other information for the purpose of acquiring or maintaining homeownership. The majority of fraud-for-profit cases involve third party brokers, or broker networks (broker, appraiser, attorney, title company, inspector), who deliberately misrepresent information to mortgage lenders, underwriters or borrowers for the purpose of increasing their profits from a transaction (Federal Bureau of Investigation). Predatory lending often involves fraud against borrowers, but even when the lender or underwriter is the target of broker fraud, the borrower is nearly always a secondary victim because their loans become overpriced, and undercollateralized, leading to high monthly payments, less chance of refinancing, and a higher risk of foreclosure (Engle & McCoy, 2002).

There is no line between mortgage fraud and predatory mortgage lending because they often overlap (as referenced in Figure 1; Engel & McCoy, 2002; Federal Bureau of Investigation, 2005). In many instances a broker could be involved in both predatory lending and fraud. For example, a broker who contacts a homeowner facing foreclosure offers to refinance. The home is actually worth $60,000 but unbeknownst to the borrower, the broker fills in the paper work claiming the house to be worth $100,000. The broker then turns in the paper work to the lending company that pays the highest commission on the loan, and the loan is approved. Both the lender[3] and the borrower are victimized, while the broker receives a larger commission from the inflated price of the home. The borrower is left with monthly payments she can't afford, and the lenders have

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[3] While it is possible that the lender and the broker can be from the same company, more and more loans each year are being arranged by independent brokers who have little vested interest in the long term stability of the lending companies.

little collateral from which to regain their investment when the borrower can't pay (Federal Bureau of Investigation). Actual fraud is not necessary for a loan to be considered predatory, but the act of fraud against a borrower is a sufficient reason to label a loan as such (Engel & McCoy).

Characteristics of Predatory Mortgage Lending

Predatory lending is a business of solicitation. Because their terms are generally unfair, and damaging, they are not likely to be very competitive in the traditional mortgage lending market. Therefore, predatory lenders do not wait for borrowers to come looking for them; rather, they actively search the market for vulnerable borrowers. The ideal customer for a predatory lender is someone who has done little or no shopping, has presupposed that because of little or damaged credit that they cannot qualify for a loan, and has significant amounts of equity already built up in their home. It is not necessary that a customer fit all these criteria, but such customers are often clustered in certain areas, such as low-income, minority, and aging neighborhoods. Strategically placed billboards, advertising in the predominant neighborhood language, and telephone and door-to-door solicitations are some of the more popular marketing techniques employed. Once at the door, a combination of hard-sell tactics, friendliness, and an aura of success lead the customer to commit to contracts and believe that the lenders have their interest at heart (Lord, 2005).

The majority of predatory lending occurs as refinancings and home equity loans, as opposed to original home purchases (Quercia, Stegman, & Davis, 2004). One of the main differences between these two types of loans is the amount of equity the borrower

already has in their home. Predatory lenders often exploit this equity by engaging in asset-based lending practices (Engel & McCoy, 2002). Loans without regard for the borrower's ability to pay seem to be against the lender's best interest because of costly foreclosures, and the loss of earnings from regular monthly payments in the event of a foreclosure. When examined closely, however, it is evident that lenders still gain through equity stripping. In fact, equity stripping is one of the quickest methods a lender can realize large profits (Engel & McCoy).

In general, equity stripping occurs when a lender qualifies a borrower for monthly payments in excess of 30-50 % of their monthly income, depending on other financial obligations (Engel & McCoy, 2002). There are even some documented instances of lenders requiring monthly payments on a loan in excess of 100% of the borrower's monthly income (Lord, 2005). Nearly all of these loans sooner or later exceed the borrower's capacity of payment and the borrower will default on the loan. With defaults come late fees, a source of profit for lenders, but more importantly, an opportunity to offer another refinancing package. The same lender will then approach the borrower and offer to help them avoid foreclosure by refinancing. This new loan package will usually include a slightly reduced interest rate, appearing to make the monthly payments more affordable. But fees for ending the original loan, and fees for processing the new loan are usually so large that they will usually offset any savings that might have been realized through a reduced interest rate (Engel & McCoy). A portion of the fees are then stripped from the equity in the home, and any remaining unpaid fees are rolled into the loan principle and incur interest over the life of the loan (Engel & McCoy).

Specific Practices

As previously explained, predatory lending cannot be explained solely by a list of egregious practices because predatory lending is also a function of circumstances. Therefore the following list is not a comprehensive explanation of predatory mortgage lending, but rather a list of the more common practices that are used in conjunction with vulnerable borrower circumstances.

Flipping

Flipping is the repeated refinancing of a borrower's loans (Lord, 2005; U.S. Department of Housing, 2000). Because prepayment penalties, opening, and closing costs can easily outweigh the benefits of a reduced interest rate, the borrower is often left worse off after repeated refinancing, having had equity stripped from the home each time (Lord; U.S. Department of Housing).

Balloon Payments/Interest-Only Loans

Balloon payments are designed to lower the monthly payments of the borrower. Often the borrower's monthly payments are only high enough to cover the interest on the loan, and in extreme cases the monthly payments do not even cover the interest, leading to negative amortization. After paying for 15 or 30 years on a loan, the borrower will find that the final payment is the original borrowed amount or more, or in other words, the entire principal of the loan is still due. Often the only way a borrower can pay a balloon payment is by getting another loan (Engel &McCoy, 2002; Lord, 2005; U.S. Department of Housing, 2000).

Prepayment Penalties

According to Farris and Richardson (2004), only about 2% of conforming, or prime loans have prepayment penalties, while 70% of subprime loans have them. Traditionally, a prepayment penalty is designed to hedge against the risk of the borrower refinancing a loan in the first few years of the loan, which reduces the amount of profit the lender makes from the transaction over the long run (Farris & Richardson). The lenders would offer reduced interest rates if the borrower entered into a prepayment penalty contract. However, the majority of loans with prepayment penalties, according to Farris and Richardson, actually had higher interest rates than loans without them.

Packing

With packing, borrowers are often sold extra loan products or charged fees without their knowledge or consent. The fees are then rolled into the loan and financed, effectively increasing the monthly payments of the borrower. It is often because of this action that borrowers are quoted a much lower monthly payment only to later find their monthly payments as much as two times higher (U.S. Department of Housing, 2000).

Excessive Fees

The HUD/Treasury report (U.S Department of Housing, 2000) said that the large fees being charged by some subprime lenders were not justified by the credit risk of their borrowers. Prepayment penalties in particular, while only one of the many fees, were said to be abusive because they strip equity from a home if the borrower chooses to refinance or sell during the first years of a loan (Lord, 2005; U.S. Department of Housing, 2000).

Lending Without Regard to the Borrower's Ability to Repay

It is not uncommon for monthly payments on a subprime loan to exceed 50 percent of the borrower's income (Lord, 2005; U.S. Department of Housing, 2000). Monthly payments on home loans are encouraged not to exceed 30% of a borrower's income (Colton, 2003). Occurrences were documented by HUD investigators in which payments on a loan actually exceeded the borrower's total monthly income (Lord; U.S. Department of Housing). Brokers gain quick cash from such scenarios through high upfront fees, and fast securitization of the loan, while investors in the securities are protected from losses by diversification over thousands of loans, and the actual houses being used as collateral (Lord; U.S. Department of Housing).

Outright Fraud

The most common cases of fraud against the borrower involve falsification of a borrower's income or home value. This can put borrowers in a precarious situation; being unable to afford the loan, and unable to refinance because lenders will shy away from such a large loan, with so little collateral (Lord, 2005; U.S. Department of Housing, 2000).

Credit Insurance

Credit insurance is designed to protect the lender in the event that the borrower dies, becomes disabled, or unemployed (Lord, 2005). It has no inherent benefits for the borrower (Lord). Most other types of insurance pay 65 to 85 cents in claims for every dollar of insurance purchased, and the suggested minimum payout by the National

Association of Insurance Commissioners (NAIC) is 60 cents for every dollar (Lord). In 2002 the payout for the 221 credit health and accident companies reporting to NAIC averaged a payout of only 49.4 cents per dollar (Lord). Additionally in that same year credit life insurance companies only paid 41.5 cents per dollar, a far cry from industry norms (Lord). If these companies had charged industry suggested rates then consumers would have saved nearly $800 million in 2002 (Lord). Many credit insurance companies are actually subsidiaries of the major mortgage lenders (Lord).

Single Premium Credit Insurance

Polished mortgage brokers are able to sell single premium credit insurance. Because a single premium policy can be thousands of dollars, the brokers will offer to finance it, or roll the premium into the rest of the loan. Insurance policies often last only 5 years, but when financed, the borrower pays interest on the policy through the life of the loan. Someone entering a 30-year mortgage in 1975 would only be covered until 1980 by his/her credit policy, but would be paying interest on this policy until 2005, well beyond the use of the policy (Lord, 2005).

Servicing

Bundles of loans are sold from the original lender to other investors. The job of collecting monthly payments is then given to a mortgage service company. Some mortgage servicing companies have participated in predatory practices, such as failure to post payments promptly resulting in late fees for the borrower; misrepresenting the amounts consumers owed, and; failing to make payments on property taxes and insurance

from escrow accounts, sometimes causing the borrower to lose their insurance or even their house because of past-due tax collections.

Other Abuses

According to Sturdevant and Brennan (1999), other abuses can include racial targeting in advertising; loans in connection with a home improvement scam; steering or leading borrowers to high cost lenders; kickbacks (payments) to third party players (broker, appraiser, attorney, title company, inspector) for steering borrowers to high cost loans; high annual interest rates; padded or duplicative closing costs and fees; mandatory arbitration clauses and associated loss of legal rights; shifting unsecured debt into mortgages; and foreclosure abuses.

Characteristics of Borrowers

Until the 1970s some bank executives allegedly drew red lines around low-income and minority neighborhoods, discouraging brokers from lending money in those areas, a practice known as "redlining" (Lord, 2005). The practice was officially ended in 1973 with the passage of the Home Mortgage Disclosure and Community Reinvestment Acts, though instances since continue to be documented (Lord). Predatory lenders have picked up where the banks left off, and have begun to "green-line" or target low-income, and minority neighborhoods (Newman & Wyly, 2002; Zimmerman, Wyly, & Botein, 2002).

A study including 10 metropolitan areas found that concentrations of subprime lending were found according to distributions of elderly and minority populations, and

not according to credit risk, indicating that those who were elderly or minority were much more likely to have a subprime loan regardless of credit score (National Community Reinvestment Coalition, 2004). Several additional studies have verified these findings (Newman & Wyly, 2002; Zimmerman et al., 2002). Moreover, large concentrations of subprime lending have been found in low-income neighborhoods (Calem, Hershaff, & Wachter, 2004; Schill & Wachter, 1993; U.S. Department of Housing, 2000). Farris and Richardson (2004) found that the likelihood of having a prepayment penalty included in a loan was more highly correlated with rural and minority homeowners than with credit risk.

Lenders have found a variety of ways in which to find and target potential borrowers who may be less educated, lack experience with legitimate lenders, live far from legitimate lenders, may lack adequate resources for shopping for loans such as a telephone or transportation, have large amounts of equity in their homes, and are behind on property taxes or in need of home repairs (Engel & McCoy, 2002). HMDA data reports where prime lenders operate (and do not operate). Census data show the exact location and percentages of minorities and income categories in neighborhoods. The tax office and deed registry shows who is close to paying off their mortgages, and those delinquent on property taxes. Another, common method used by home improvement scammers is to simply drive by poorer neighborhoods in search of houses with obvious needs for improvement on the exterior, and then offer these homeowners a home-improvement loan, of course with high and hidden costs (Engel & McCoy).

Lending Factors

Main Street Lenders

It is estimated that brokers handle about half of all mortgage loans (Senate Committee on Banking, 2001). Brokers have incentives to steer borrowers to lenders that pay brokers the most rather than to lenders who give borrowers the most favorable terms (Senate Committee on Banking). In addition to brokers; lenders, real estate developers, and real estate agents are often paid a commission based on the value of the loans they secure (National Community Reinvestment Coalition, 2005). Appraisers also get dragged into the mix and can face extreme amounts of pressure to deliver overstated values (National Community Reinvestment Coalition). Appraisers who do not deliver the sought after, overstated values are often withheld payments, threatened with loss of business, and are sometimes even blacklisted by lenders. Lenders have also been known to "shop around" for appraisers for each property, choosing the one that gives the highest price estimate (National Community Reinvestment Coalition). Whether actual collusion among mortgage market professionals is voluntary or forced is not as relevant as the mere recognition that incentives between actors in the market often leads them to pursue activities that are not in the best interest of the borrowers.

Wall Street Lenders

Table one shows that predatory lending is not an isolated phenomenon, but instead is a widespread failure in the mortgage market. Wall Street firms continue to directly and indirectly support predatory practices. Conseco Financial (Green Tree), for example, would not have been able to carry out its injurious practices without the backing of some big Wall Street names. Six insurance and mutual fund (investment) companies

were the main purchasers of Conseco mortgage backed securities at the time of its $27 million settlement: Denver based Great-West Life & Annuity Insurance Co., Japan based Nippon Life Insurance, L.A. based Met West Financial, Boston based John Hancock Financial Services, Iowa based PFL Life Insurance, and Pittsburg based Mellon Financial Corp (Lord, 2005). Given the tendency of investment corporations to make informed investment decisions, it is reasonable to assume that Conseco's widely criticized lending practices were well known to these investors who made the decision to purchase shares of the securities anyway, based not on moral perspective but on alluring potential returns. Ironically, it is conceivable that those who were injuriously overcharged by Conseco were also owners of life insurance policies, or mutual fund investments made in the above named companies and therefore may have indirectly financed their own thieves.

An interesting note is that the settlements from Household Financial and the Associates are the largest non-tobacco consumer settlements in history. Also worth note is that despite the large total of the settlements, the compensation to individual victims is still far from adequate for even covering the losses they incurred from lending abuses, and are far from inflicting any punitive or disciplinary costs to the companies (ACORN, 2003).

Summary

Because predatory mortgage lending is a relatively new phenomenon, and the problem itself is so broad and undefined, only a handful of academic research articles on the topic exist (Calem et al., 2004; Elliehausen & Staten, 2002, 2003; Harvey & Nigro, 2002; Hogarth & Hilgert, 2002; Lax, Manti, Raca, & Zorn, 2004; Morgan Stanley,

Table 1

Companies Involved in Lawsuits over Accusations of Predatory Lending

Company	Parent/ Affiliate Company	Monetary Settlement/ Judgment	Additional info	Year	Source
Union Mortgage	Skopbank (Finnish)	$57 million	Home improvement schemes.	1991	(Consumer's Union, 1997)
Chrysler First	Nation's Bank	$2.15 million	Abusive lending practices.	1993	(Consumer's Union, 1997)
Fleet Finance	Fleet Financial Group Inc.	$115 million	Agreed to fund National Association of Consumer Advocates mortgage product with $140 million in mortgages (in addition to the $115 M).	1993	(Consumer's Union, 1997)
United Co. Financial Corp.	United Co. Lending Corp.	$4.5 million	Denied any abusive lending.	1993	(Hudson, 1994)
Empire Funding Corp.	Empire Funding Holding Corp.	$1 million	Rescission of mortgages.	2000	(Donovan Searles, LLC, 2004)
Equicredit Corp.	Bank of America Corp.	$2.5 million	Each victim only received about $200. 800 families avoided foreclosure. No admission of wrongdoing.	2002	(Davies, 2002)
Mercantile Mortgage Co.	South Financial Group	$250,000	Free refinancing to customers on more favorable terms	2002	(Federal Reserve Bank of Chicago, 2003)
Delta Funding Corp.	Delta Financial Corp.	$12 million	Promised to no longer discriminate between borrowers, to stop the payment of unearned broker fees, and to cease lending to persons who cannot afford payments	2002	(Yeomans, 2001)
First Alliance Mortgage Co.	First Alliance Corp.	Assets liquidated ($60 million)	Company filed for bankruptcy and liquidated its assets. CEO's prohibited from future mortgage lending in 6 states and fined $20 million	2002	(Federal Trade Comm., 2002)
The Associates (renamed CitiFinancial Credit Co.)	Citigroup Inc. (The largest financial company in the world)	$240 million	Sales practices and products are now closely monitored by the FTC. Largest consumer protection verdict to date.	2002	(Lord, 2005)
Green Tree (renamed Conseco Financial)	Conseco Inc.	$27 Million	Promised not to make loans to people who couldn't afford them, not to change loan terms at closing, not to include balloon payments in home equity loans, not to enroll expensive insurance policies into loans. Never admitted to any predatory actions.	2002	(Lord, 2005)
Household Finance Corp.	HSBC Group	$484 million	Denied any involvement in predatory lending. The largest non-tobacco consumer settlement in history.	2002	(Lord, 2005)
Household Finance Corp.	HSBC Group	$100 million	Implementation of home foreclosure avoidance program. Lower interest rates, waive late charges, defer unpaid interest and fund a financial counseling program for borrowers at risk of foreclosure.	2002	(Oklahoma Consumer Issues Update, 2003)
Fairbanks	PMI Group Inc.	$40 million	Admitted no wrongdoing	2003	(Lord, 2005)
Wells Fargo Financial	Wells Fargo Bank	0	After years of pressure and bad publicity, Wells has taken actions to reduce certain predatory features from loans. These actions have been criticized by many as mere fanfare, with many practices continuing unhindered.	2005	(Dinnen, 2005)
Capital City	Capital City Mortgage Corp.	$750,000	Agreed to no longer sell home-based loans	2005	(Fleishman, 2005)
Ameridebt Inc.	Debt Works Inc.	$170 million	Filed for bankruptcy, with assets being liquidated and dispersed. Never admitted any wrongdoing.	2005	(Federal Trade Comm., 2005)
Ameriquest Mortgage	ACC Capital Holdings Corp.	$325 million	Denied all allegations but agreed to change fundamental practices.	2006	(Downey, 2006)
ABN AMRO Mortgage	ABN AMRO Mortgage Group	$3 million (proposed)	Plaintiff's are asking for increased regulation on predatory lending activities, in addition to payments of damages.	pending	(Consumer Education, 2005)
Washington Mutual Finance Group	Washington Mutual Inc.	$7 million (proposed)	If class action suit is successful, all customers lose their rights to seek further punitive damages.	pending	(Trial Lawyers for Public Justice, 2005)

2002; Quercia, Stegman & Davis, 2003, 2004; Stein, 2001). Many of these studies have limited scopes that do not adequately cover all features of predatory lending, but focus instead on very limited and incomplete features. This is not to say that these studies are useless; in fact they have furthered the acceptance of the reality of predatory lending to the point of influencing some state and federal regulations. However, confusion still looms among regulators, industry lenders, and even consumers on what exactly predatory lending entails. This research will enable predatory lending in Utah to be understood through expert opinions of those who regularly witness predatory lending and its effects, first hand.

CHAPTER III

METHODS

The Qualitative Research Paradigm

The core goal of this research was to define predatory mortgage lending according to the understandings of home loan professionals for the purposes of future education and regulation. Because views and understandings of the topic were expected to be diverse, and somewhat unpredictable, a more naturalist, or qualitative approach was appropriate (Rubin & Rubin, 2005). This research was also facilitated by a detailed log of decisions made throughout the research process, including reflective thoughts of the principal investigator, as consistent with the qualitative approach described by Creswell (2003) and Rossman and Rallis (2003). Particularly during the interviews, this approach was useful for capturing highlights, nonverbal evidence, and initial emergence of important concepts and themes. Additionally, an assistant researcher with previous experience in qualitative studies also served as second evaluator for the purpose of triangulation and verification throughout the research process (Rossman & Rallis).

Consistent with the modern qualitative approach (Creswell, 2003), the data collected from the interviews were not limited to verbal responses, but also included voice inflections and nonverbal cues, as well as personal records, relevant documents, emails, and so forth, as explained later in the data collection procedures. Interviews were also conducted in the interviewee's natural setting as suggested by Creswell, meaning that the mortgage lending professionals were asked to choose the location of the interview. All participants chose their primary place of business, or a similar setting.

Creswell discussed that advantages of the natural setting include the ability for the researcher to witness high levels of detail about the interviewee's environment and allows the researcher to become highly involved in the interviewee's daily experiences. The primary role of the researcher was to guide the interview between each main question using follow-up questions and probes, a method of interviewing that is discussed later.

Unit of Investigation

Mortgage lending professionals are arguably the most knowledgeable people available to assist with the understanding of predatory mortgage lending. Intuitively, mortgage professionals deal with mortgage borrowers and lenders on a regular, full-time basis, and therefore, are in a position to witness their daily interactions, deals, and disagreements. A mortgage lending professional can be loosely defined as any person whose career requires regular, full-time contact with either mortgage borrowers, mortgage lenders, or both. Duties of a mortgage lending professional range anywhere from education and counseling, to regulation or business. Because the purpose of this research was to more accurately define predatory lending as it currently exists in Utah, the unit of investigation was the mortgage lending professional.

Sample and Recruitment

As opposed to large scale surveys where quantity and frequency of opinions are sought (Morgan Stanley, 2002), this study encouraged a detailed qualitative approach. Each interviewed professional was encouraged to contribute a significant amount of detail to his/her responses, so that a richly informative illustration of noteworthy details

was possible. The selection of participants began with a preliminary list that was compiled by the primary and assistant researchers. This preliminary list was suggested by several professional acquaintances of the researchers who had previously been involved with some of the groundwork for this project. Those officials who participated initially were asked to identify other potential participants who could offer additional insights about predatory mortgage lending. These suggestions comprised the remainder of the sample. This method of sampling is known as snowball, or chain sampling and has been used in many qualitative studies like this one (Patton, 2002). Special effort was made to include equal samples of participants with predispositions for consumer advocacy, industry advocacy, or neutrality such as regulators.

Interviewees were initially contacted by phone or email, at which time the primary researcher gave his name, university association, and explained the topic of the interview. The primary researcher then asked for an interview and explained that because of the nature of the interview, the length would be at their discretion, but would likely last between 30 to 90 minutes. At that time incentives for participation were also mentioned as described in the following paragraph.

Because of the primary researcher's previous experience with those in the mortgage lending market, it was anticipated that the vast majority of the sample would participate with few or no incentives. Nevertheless, the participants were offered a personal copy of the final project as an incentive for their participation. Additionally, the primary investigator offered to share highlights of the project in classes and workshops through which associates of the participants may also benefit from this research.

When an agreement to participate was given, a time and a place for the interview was then determined by the interviewee. At the time of the interview, each participant was again informed of the purpose of the study, possible adverse effects of participation, and their rights to withdraw or withhold information. They were also asked to sign the Institutional Review Board (IRB) approved informed consent form as an acknowledgment of their decision to continue with the interview (see Appendix A).

The final sample included 12 full-time professionals who work in Utah, and who were chosen without geographical preference. Although most of the interviewees were concentrated along the Wasatch Front, many have had experiences working all over the state. The final sample included four consumer advocates, four industry advocates and four neutral participants who have 182 years of collective experience in nearly every conceivable area of the mortgage lending market. Consumer advocates have had previous experience in banking, real estate lending, and as loan officers, educators, counselors and paralegals. Industry advocates have past experiences as lawyers, state managers, regional managers, loan officers, owners, sales managers, branch managers, national sales directors, managers of home sales, and special assets managers. Neutral participants have experiences as mortgage brokers, appraisers, real estate brokers, asset managers, non-profit workers, bankers, lawyers, loan officers, community developers, fair housing workers, regulators, and educators. Table two gives further descriptive details about the participants.

Table 2

Respondent Characteristics (n=12)

	Predisposition		
	Consumer Advocates	*Industry Advocates*	*Neutral Participants*
Number	*4*	*4*	*4*
Male	*1*	*4*	*2*
Female	*3*	*0*	*2*
Mean years of experience	*8*	*13*	*24*

Data Collection Procedures

While obtaining the proper signature on the IRB approved informed consent form and during the course of the interview, the primary researcher engaged in initial assessments of the characteristics of the interviewee and his/her surroundings, including the interviewee's gender, general age, nature of their place of employment (large, small, public, private), and other environmental qualities (busy, many coworkers, etc.). Next, the interview questions commenced (see Appendix B).

Follow-ups and Probes

In qualitative interviews, follow-up questions are used to explore themes, concepts, and ideas introduced by the interviewee (Rubin & Rubin, 2005). Probes are used as subtle communications which ask for more detail, or further clarification of previous statements (Rubin & Rubin). Follow-up and probing questions were incorporated into the interviews but were not scripted because they were used to clarify and expand on comments made during the interview, and were therefore not foreseeable. Examples of follow-up questions included: "Could you tell me more about what you just

said?" or "What did you mean by that?" or "Why is that important?" Similarly, probes were used to indicate for the interviewee to continue, and keep the interview moving. Examples of probes were, "OK," "I see," "That's interesting," and sometimes even included nonverbal cues such as a nod of the head or lift of the eyebrows. The general intent of probes was to show the interviewee that what he/she is saying is of value and for subtle encouragement to continue (Rubin & Rubin).

Pilot Interviews

Two pilot interviews were conducted with the intent of refining the interview questions. The purpose of these interviews was to clarify any confusing wording in the questions, and to determine the effectiveness of the questions for extracting a useful meaning of predatory lending in Utah. Feedback from these participants served as a verification of the reliability and validity of the interview questions by helping to ensure unbiased wording in the main questions. According to these initial participants the main questions effectively served their purpose of defining and describing predatory mortgage lending, and the wording did not require any alteration.

Procedures

The participants were interviewed by using the tree and branch method. The tree and branch method described by Rubin and Rubin (2005) began with the main research topic: predatory mortgage lending in Utah. This topic was then explored using seven main questions and subsequent follow-ups and probes. The result was an array of comments that branch from the seven main questions, all of which stem from or describe the main topic. The direction, nature and content of the responses were thus determined

by the interviewees while ensuring a thorough covering of the main research topic (Rubin & Rubin).

Four types of data collection are common in qualitative research: observation, interviews, documents, and audiovisual materials (Creswell, 2003). The primary mode of investigation in this research was through the interviewing of participants as described previously; however, observations, documents, and other evidence were also used when offered by the interviewees. Because all of the interviews took place at the participant's place of employment, observation of their environment and interactions were easily obtained. Likewise, during the course of the interviews, some participants offered the researcher documents such as additional literature, official reports, letters and emails, as evidence of a certain point, and these were used in the final analysis. It is worth noting that this type of information was not solicited during the interviews, but was included as evidence only when offered at the interviewees' own initiatives.

Data Recording Procedures

For the interview, the researcher's notes were divided down the middle of the page, with one side containing key words and phrases made by the interviewee, and the other side containing the researcher's personal thoughts and reflective notes. Observations of actions and expressions of the interviewee, notes on the environment, and other occurrences were also included in the reflective notes. The columns for the interview and reflective notes were parallel, maintaining a chronological flow of comments and ideas as they came, while retaining a separation of the researcher's notes

from what was actually said by the interviewee. Interviews were also audio recorded, and transcribed into text for further analysis, which is described in the next section.

Data Analysis Procedures

All the interviews were transcribed into text from their audio versions. As a check for maintaining credibility of the interviews, the transcribed copies of the interviews were sent to each respective interviewee via postal mail or email. The interviewees then had a chance to correct, add to, or otherwise change the content of their interviews, thus serving as a "member check" of reliability.

The interviews and notes were then read through initially to glean the overall meaning of the data collectively. Notes and reflective thoughts were written in the margins for subsequent use. Next, general coding of the data began through labeling of sections of the material by topic. To be consistent with the ideas of the interviewees, the labels were often terms supplied by them during the interviews, and not terms imposed by the researcher; these are called "in vivo" codes. Each interview was treated on a more individual basis in this step. As an additional step of ensuring reliability, this step of labeling was also preformed by both the primary researcher and the assistant researcher for purposes of comparing consistency and logicality of labeling. No major or persistent inconsistencies were found; therefore, the primary researcher coded the rest of the data alone.

Topics were then grouped together and organized into three major categories: comments on a definition, comments on a description, and other information. Content of the major categories was then divided into several descriptive categories. The material

was then reread; this time the researcher added more specific codes for the material in the descriptive categories. The interviews at this point were treated collectively, meaning that there was little recognition as to who the authors of the comments were, but rather each quote was treated for meaning, and not for its source of origin. The relating nature of the quotes helped to organize the supporting evidence into a significant description of major and minor concepts that make up predatory mortgage lending. The codes were then organized into a narrative or description of predatory lending as supported by the evidence in chapter four. This method of managing qualitative data was performed on NVivo7, a computer software program designed for the purpose of analyzing qualitative data (QSR International, 2005). This software proved to be user friendly and more time efficient than the traditional folder method. In the narrative, the major findings were supported by multiple or longer, more detailed quotes, while unique perspectives were supported by only one or two less detailed comments. A detailed description of the chronological protocol of this investigation is depicted in Table 3.

Table 3

The Successive Phases of the Investigation

Phase	***Step***	***Description***
Phase I – Preparation	Obtain Background	Through a thorough investigation of academic literature, and a continued monitoring of current events for the past two years, the primary researcher has acquired an informed background on the topic of predatory mortgage lending.
	Form the Interview	Main interview questions and guidelines have been constructed from relevant literature.
	Locate Potential Interviewees	A preliminary list of potential interviewees has been formed.
Phase II – Approval	IRB Approval	The Institutional Review Board (IRB) approved the study to ensure that the rights of human participants in the study were protected.
	Committee Approval	The members of the research committee approved this research.
Phase III – Pilot Interviews	Obtain 2 initial interviews	The purpose of these initial interviews was for testing the interview questions for content and reliability.
	Feedback	Feedback was obtained from these participants on the usefulness and clarity of the interview questions.
	Refining interview questions	The interview questions did not need to be adjusted or refined based on feedback of the initial participants.
Phase III – Data Collection	Interviewees Contacted	The first several interviewees were contacted, explained the purpose of the study and asked for an interview.
	Meet for Interview	Meetings were held at locations specified by the interviewees.
	Audio Recorder	The audio recorder was used.
	Interview Introduction	Interviewees again had the purpose of the study read to them.
	IRB Rights	Interviewees had their rights as human subjects read to them including the right to withdraw at any time.
	Research Questions	The research questions were asked along with follow-up and probing questions.
	Notes	Notes were taken to record thoughts and reflections of the researcher during the course of the interview.
Phase IV – Data Analysis	Transcription	The interviews were transcribed from the audio tapes into text and put into folders.
	Review	The interview texts and notes were initially reviewed for general meanings and nature of responses.
	Overview	The interviews and notes were again read to capture the major topics.
	Topics labeled	Individual interviews revealed important topics which address the main research questions and these topics were labeled.
	Organize topics	Topics organized conceptually using NVivo7 computer software.
	Categories	Descriptive categories were formed out of the topic material.
	Add codes	Material was reread and the category codes were assigned to subsections of the interviews, sometimes more than one category was used for each subsection depending on the interrelation of concepts.
	Evidence	The definition of predatory mortgage lending yielded itself from the major and minor supporting evidence from the interviews.
	Discussion	The findings will be discussed in light of literature and the new evidence.
Phase V – Report Findings	Report findings.	The findings of the research will be reported in a thesis project, academic articles, and a report to the Utah Division of Real Estate.

CHAPTER IV

RESULTS

The results are presented in the same order as the study's objectives found at the end of chapter one. This conceptual organization was not only supported by the literature but also by the participants of this study. First, a definition of predatory lending is presented using the words of the expert panel. Next, descriptive evidence is presented that addresses objectives two through six. These include descriptions of the magnitude of predatory lending, factors and conditions that spur its existence, practices that are considered predatory, characteristics of victims, and suggestions of ways to reduce it. Near the end of the chapter there is an additional section that describes the consequences of abusive and predatory lending, and whom it affects.

Research Objective One: A Definition[4]

Abusive Lending

"There is a fine line between the practice and abusing the practice," began a predatory lending specialist. But when participants were asked the definition of abusive lending it became apparent that the line was not so fine after all. Similar to current literature, many of the participants began defining abusive lending by listing practices that they considered abusive. A consumer advocate described, "It's abusive when people get taken advantage of and income changes. It's also abusive when they prey upon the elderly and the uneducated, with high repayment terms in general."

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[4] See Appendix C for diagram of coding scheme for each objective.

The chore of defining abusive lending became much more difficult by excluding the citation of specific practices; nevertheless, by piecing together direct references that addressed abusive lending, a firm definition was derived. Therefore, abusive lending consists of one or more of the following: (a) a transaction without a fiduciary duty or having the borrower's best interest in mind, (b) a transaction the borrower does not completely understand for any reason including age, language barrier, or lack of financial savvy, (c) any transaction that results in harm to the borrower, (d) any loan that delivers the lender excessive profits, and (e) any loan that the borrower does not have the ability to repay.

The definition is not perfect, but is a good starting point. One problem with this definition is that it is so broad that it may not be applicable in every situation. For example, it is theoretically possible for a lender not to have the best interest of the borrower in mind, but still deliver a loan that is entirely beneficial to the borrower. A second problem is that the definition is not measurable. For example, borrower understanding is not easily measured and therefore one could never accurately determine whether or not a borrower completely understood his or her loan transaction. Imperfect as this definition may be, it still provides a useful background for analyzing predatory lending.

Predatory Lending

Similar to descriptions of abusive lending, participants routinely defined predatory lending by citing specific acts that are predatory. One neutral participant related:

> Some attempts to define it, that we have seen include things like, "What was the loan to value ratio? What was the percentage of income, as compared to the payment? How many points above market rate is the person getting the loan?"

Nevertheless, without citing specific activities, participants were able to collectively define predatory lending as one or more of the following: (a) unfair or abusive lending practices that are targeted towards vulnerable borrowers; (b) preying on, or taking advantage of borrower vulnerabilities; (c) excessive profits from single loans; and, (d) a loan without logical benefit to the borrower. Part (a) of the definition refers directly to the previously established definition of abusive lending. Parts (c) and (d) of this definition also bear a striking resemblance to the definition of abusive lending. Predatory lending is therefore defined through the use of the definition of abusive lending. In fact, only one major difference seems to exist between them; namely, the act of targeting or preying on individual borrower vulnerabilities for predatory lending, whereas abusive lending include the same occurrences, but without a defined target. Further evidence to support this conclusion is given by participants who directly compared abusive and predatory lending.

Predatory Lending Versus Abusive Lending

Half of the participants explicitly made statements similar to one made by a consumer advocate that "Abusive loans are the same thing as predatory loans. Pretty much one and the same." This relationship is depicted in Figure 2. Other participants described an overlapping order similar to the following idea shared by an industry advocate, "In the realm of things you've got all lending, and then you've got abusive lending and then you have . . . predatory." This relationship is shown in Figure 3.

Though supported by many sources, the overlapping order was not explicitly supported by all, but because these two perspectives are not inherently contradictory it is possible to combine them into a hybrid model portrayed in Figure 4. This hybrid model supports the majority of the participants' explicit perspectives, and because of the evidence discussed above, it can reasonably be concluded that the differences between predatory lending and abusive lending are slight.

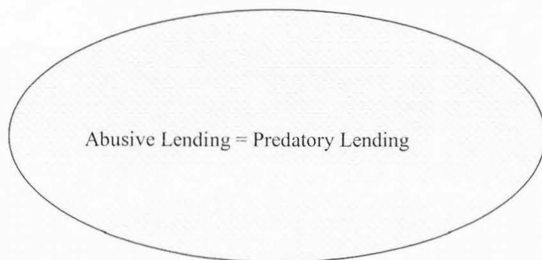

Figure 2. Little or no difference between abusive and predatory lending.

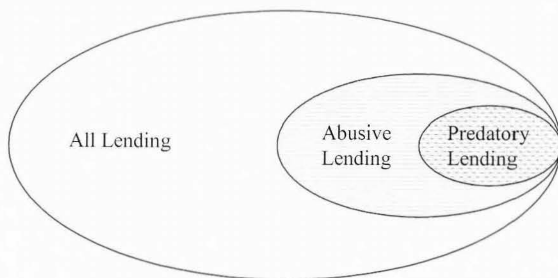

Figure 3. The overlapping order of lending.

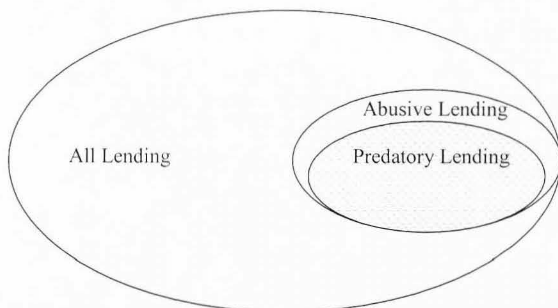

Figure 4. Hybrid model of abusive and predatory lending.

Fraudulent Lending

Fraud is essentially any illegal activity in the mortgage lending market. The most common examples of fraud that were shared by the participants included a failure to deliver all the required disclosure documents at closing, and the falsification of disclosure documents. Fraud is not limited to illegal activity that harms the borrower. One participant who deals regularly with fraud explained that fraud can originate for the sole purpose of defrauding the lender. For example, if a borrower knowingly posed as an interested customer and helped a broker to defraud a lender, both the borrower and the broker would be members of a conspiracy. The expert on fraud went on to explain, however, that brokers are capable of defrauding the lender without disclosing to the borrower thier role in the conspiracy:

> If you approached a member of a vulnerable class, or single mother, and said, "I'm going to give you $500 go ahead and sign these forms." That person, because they may not understand the legal requirements or what they are committing or doing, could also be a victim.

Therefore there are cases of fraud in which both the borrower and the lender are simultaneously harmed. The key is that borrowers are abused directly and indirectly through illegal activity, as the fraud expert concluded:

> Was the woman abused? . . . I think she was a victim to mortgage abuse. I think there were guys that knew enough about the business, to where they knew how to formulate a loan package and submit it to an underwriter, and get it approved and took advantage of someone who was a victim and yet they were a party to the fraud because they went along with it.

Fraudulent Versus Abusive and Predatory Lending

To reiterate, the main difference between predatory and abusive lending is the act of preying on or targeting a victim, and the main difference between predatory and fraudulent lending is the crossing of legal boundaries. An industry representative stated, "Fraud can be both abusive and predatory," or illegal acts can be and often are targeted and harmful. According to the comparative evidence mentioned, another element can be added to the figure depicting the relationships of terms in Figure 5. While certainly not precise in proportions, the idea illustrated in this figure is that according to our participants, the terms abusive lending, predatory lending, and fraud (against the borrower) are very similar, and often used interchangeably.

Figure 5 bears remarkable similarities to Figure 1 that was derived from the literature. In fact, the only differences are that (a) the literature does not make a conceptual comparison of abusive and predatory lending; and (b) participants did not make an explicit separation of prime and subprime lending.

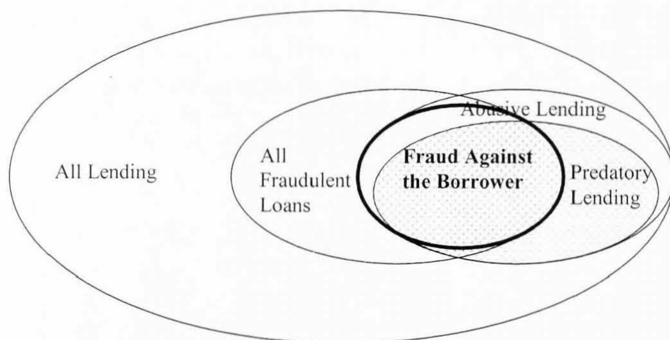

Figure 5. Relationship of fraudulent lending to other types of lending.

As introduced in chapter two of this research, the majority of predatory mortgage lending occurs in the subprime market though there are also occasional instances in the prime market. Mortgage fraud also occurs in both markets though the majority of fraud that harms borrowers occurs in the subprime market. These ideas were also supported by the participants. Unlike the literature however, participants also defined abusive lending as inclusive of all predatory lending. Figure 6 combines the ideas found in the literature and the interviews.

The Term "Predatory Lending"

While the majority of the 12 participants agreed with nature of the relationships of terms depicted in figure six, there were a few dissenting opinions. Even though many participants used the terms more or less interchangeably, some did not explicitly see them as the same. For example, referring to abusive and predatory lending, one lender said, "I would say they are two different factors."

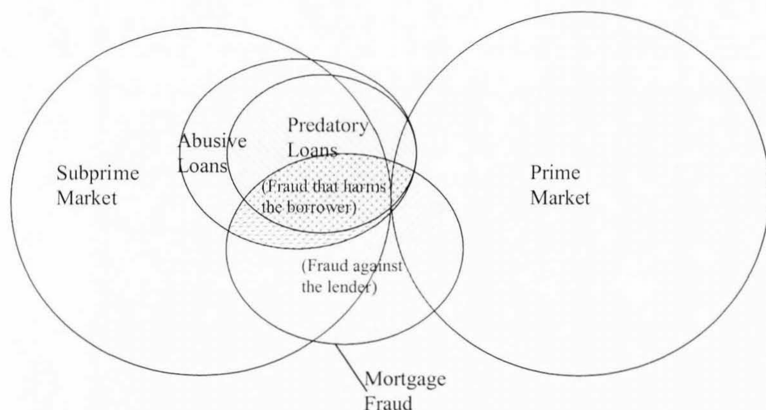

Figure 6. Relationships of market elements based on participants and the literature.

Though these few dissenting opinions may seem to invalidate the accuracy of Figure 6, further evidence supports the idea that Figure 6 is in fact correct, and that discrepancies actually originate through the misunderstanding of terms. For example, one participant who is involved in regulation, explained that the term predatory lending in particular, can have widely varying meanings from one person to the next, and is heavily influenced by one's background. In other words, it is likely that lack of participant unanimity in the findings depicted in Figure 6 stem from incomplete or biased information rather than true discrepancy. This was further validated by interchangeable nature of the terms as used by the participants.

"Predatory lending" is a catchy term, and this perhaps is the reason for its continued usage, but it has evidently taken on a wider meaning than was originally intended. When speaking of predatory lending, the majority of participants neither

confined themselves to acts of predation, nor did they necessarily portray lenders as the perpetrators. They did not confine themselves to descriptions of unethical acts; they also described illegal or fraudulent activities as being predatory. In other words, the term predatory lending serves as more of a catch-all for all types of unfair, home-based lending practices rather than as a narrowly defined term. On the inadequacy of the term predatory lending one branch manager vented:

> I don't like the term predatory lending. There's something about that term that really bothers me as a lender. But I don't know a better term for it. And that's the term everybody is using, but it's such a broad paintbrush that I wish someone would come up with a better definition for it, and figure that out.

In short, the term predatory lending has no inherent meaning in and of itself, but rather different meanings are ascribed depending on who is using the term. When lenders, borrowers, consumer advocates, legislators, reporters, and researchers use the term predatory lending it is very likely that they are all referring to a slightly different concept. According to participants, achieving common understanding is more important than trying to settle an impossible argument of semantics. Therefore, regardless of what specific term was used it became apparent that the majority of the participants' comments were simply referring to unfair practices in the mortgage lending market, and were not limited to predatory acts, illegal acts, unethical acts, or those specifically involving a lender, but was rather all inclusive as depicted in figure seven.

Because of the inclusive nature of unfair lending, a definition combines the elements from the previously established definitions of predatory and abusive lending. Therefore, unfair mortgage lending practices are defined as one or more of the following conditions: (a) a transaction without a fiduciary duty or having the borrower's best

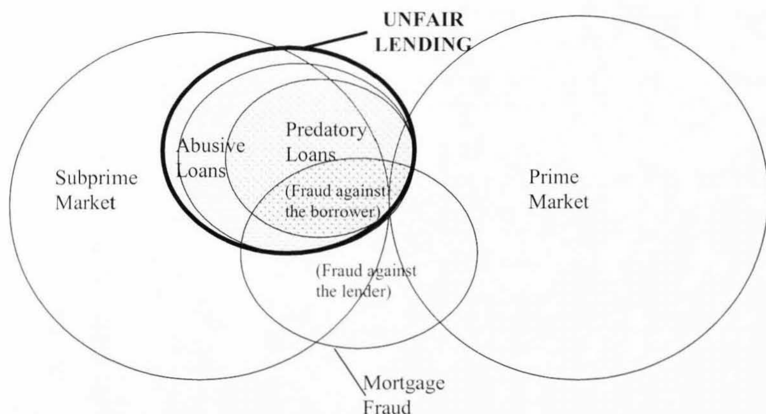

Figure 7. Unfair lending.

interest in mind, (b) a transaction the borrower does not completely understand for any reason including age, language barrier or lack of financial savvy, (c) a transaction that has no beneficial use or results in harm to the borrower, (d) a loan that delivers the lender excessive profits, and (e) a loan that the borrower does not have the ability to repay.

As further evidence will suggest, this definition is more detailed and encompassing than the definition given in the 2000 HUD/Treasury report (see p. 4), and for purposes of conceptual understanding, this definition provides a much more useful starting point, specifically for Utah (U.S. Department of Housing, 2000). Yet, again this definition is not intrinsically useful for constructing remedies to the problem because of vague generalizations and the lack of measurability. Though discouraging these shortcomings are not surprising given that previous studies have encountered similar

problems (Special Committee on Aging, 2004; Stein, 2001; U.S. Department of Housing, 2000). With each further study on the topic it has become apparent that measurable definition of predatory mortgage lending is unattainable. In anticipation this lack of measurability, objectives two through six were also included in this study so that specific details and measurability might be achieved through this study. The remaining sections of this chapter consist of additional comments made by the 12 mortgage lending experts and are intended to supplement this newly formed definition by offering a more specific, applicable, and measurable understanding of unfair lending practices in Utah.

Research Objective Two: The Magnitude of Unfair Lending

Sources named specific places in Utah that had experienced unfair lending practices including St. George, the west side of Salt Lake Valley, West Valley City, Ogden, and Sandy. One person also implicated the entire Wasatch Front as more or less a hotbed of unfair lending activity.

One neutral participant and one industry advocate explained that they felt the problem was minimal, while another industry advocate felt that it was more of a moderate problem. Yet, the majority of the participants of this study explained that unfair lending was a large and increasing problem by relating quotes similar to these made by two consumer advocates, "It is significant, probably makes up 5-10% of the new loan originations," and, " . . . it's just a huge problem."

Many of the participants considered foreclosure, bankruptcy and default rates as additional indicators of unfair lending practices. A family finance expert explained this view:

> If you look at Utah's default rates, bankruptcy rates, I would say it's pretty high because they all correlate. All of it plays in . . . the bankruptcies, the defaults, all of that tie into it all together.

Research Objective Three: Victim Characteristics

Most often the term victim is synonymous with the term borrower. As discussed in the first section of this chapter, this is not always the case because there are instances in which a person or entity other than the borrower becomes a victim, or in which the borrower who was originally a co-conspirator later becomes a secondary victim. Descriptions of the characteristics of all three types of victims were shared by the officials.

The Co-conspirator

One participant who deals extensively with cases of mortgage fraud explained that borrowers often act as co-conspirators in attempts to defraud a lender. The co-conspirator is often a single minority female with good credit who has a trusting relationship with the dishonest broker. This expert explained that even the borrower, though a party to the fraud, often becomes a secondary victim:

> The area where I see it, primarily mortgage brokers, that have enough knowledge of certain loan products, and they have a certain knowledge of the way the industry functions that they know where there is wiggle room, and so they capitalize on it. And they seek out a victim who is also a party to the fraud, and then they sort of exploit them . . . and the person goes along with it . . . and even though they've seen certain red flags go up, they still keep going for the bait, and then after the deals closed and the house of cards falls on them, then they know they've been had.

Thus the borrower is sometimes taken advantage of in cases of fraud and, and in other cases is a full accomplice. The distinction depends on how much the borrower knows, and can sometimes be difficult to determine.

Non-borrowers

Cases of fraud usually target, as the primary victim, the sources of funds such as a lender, the secondary market, or investors in general. A participant with over 40 years of experience in the homebuying market explained:

> In Utah, what we are talking about is that the victim is usually the lender; some rogue professional in a mortgage broker company has staged inflated prices and got a loan . . . . More investigations center around the lender, the bank, the wholesaler. They are the ones who are duped. They are the ones who think they are holding an 80% loan but in reality it's a 140% loan.

This expert explained that ultimately those who invest in mutual funds and other companies that hold the values of those mortgages through the secondary market suffer because of unfair and fraudulent loans:

> The other victim is gray haired people like me who's 401(k) relied on a money market manager managing my 401(k). He's very good at crunching yield rates of return but he thinks the appraiser, the mortgage broker, the real estate agent, he thinks the system already did the risk analysis for him, but they didn't. He was fooled. The system broke down.

This leads to a lower rate of return than investors should rightfully receive. On the surface this may appear to be only a minor problem, though for individuals who use these investment vehicles for retirement savings the disparity could ultimately result in the loss of hundreds of thousands of dollars of retirement income.

Borrowers

Though the losses to the industry and to investors caused by unfair lending can be substantial on the whole, they rarely have the same devastating impacts that are often incurred by individual borrowers. Borrowers are not as diversified as investors usually are, and they cannot pass on the costs to customers as the industry can. A borrower can suffer life altering losses due to unfair lending, and this is why they receive so much attention. There are certain characteristics that seem to make a borrower more vulnerable to unfair lending practices. The characteristics of borrowers as described by the officials can be characterized as (a) their personal attributes, (b) their emotional state, (c) their financial characteristics, and (d) their general ability to understand home loan transactions.

Personal attributes. Victims are likely to either be very young, or very old, and of minority status according to participants. One homebuying counselor described several experiences of working with very young couples who sometimes were not yet even married but were trying to arrange financing for a home. Older adults seem to be a more popular target, especially for refinancing or equity based loans due to built up equity that has been accumulated over a lifetime. Older adults are sometimes increasingly vulnerable due to loss of former capacities, as seen in an example shared by a neutral participant:

> But they can also be people who once were very sharp but they are elderly and they have slowed down . . . that happens to someone who was an attorney or a CEO of a company, that they've been retired for 20 or 30 years and they are a little slow, yet they are too proud or too embarrassed when they even think that its going south to say anything until its too late.

Minority group members also tend to be victimized disproportionately, though most interviewees cited language barriers as the real cause of vulnerability. The language barrier can prevent a minority individual from doing adequate shopping, and may lead to agreements with the first person they feel they can trust, whether of not their rates are competitive. Many times this leads to instances of lending cannibalism, which involves a lender or broker of the same ethnic background taking advantage of minority borrowers because of assumed trust and lack of options.

Though minorities may have a somewhat legitimate reason for not pursuing other borrowing options, they are not the only ones who fail to shop and price compare before entering a loan. Victims are sometimes thought to be somewhat irresponsible when it comes to protecting themselves, particularly by not taking the initiative to shop around for good deals. Still, others attribute this failure to shop around not to a lack of responsibility, but rather to an overly trusting attitude. Officials indicated that Utah borrowers are overly trusting especially when it comes to mortgage lending because as a homebuying counselor explained, "People put a lot of trust into those professionals."

Several participants explained that there are so many diverse characteristics that could make someone more susceptible to unfair loans that it is perfectly reasonable to assume that anyone could potentially be a victim. One neutral participant summarized by saying, "Minority groups, seniors, low-income, and actually, it can be anybody."

Emotional characteristics of borrowers. Emotional characteristics also play a key role in borrower vulnerability. Feelings of desperation are common emotions and can stem from excessive debt. Mortgage debts are perhaps the most pressing; missing only one or two payments can send the borrower into a panic to avoid foreclosure, which can

lead to acts of desperation. Borrowers in these precarious situations are apt to be more receptive to loan solicitations, as one lender explained:

> You get a little bit desperate and for instance . . . I'm down maybe two mortgage payments, and the mortgage company keeps calling me and they're sending me these letters and telling me I'm going to get foreclosed on, and then all of the sudden I get a call from a telemarketer or from a mortgage broker who says, "Hey, we can take care of your problems," and then emotionally, I think I'm more willing to take care of the immediate problems, and not think of the long-term consequences that this high interest rate loan is going to have on me.

Additionally, peer pressure seems to play a large role in borrowers overstepping their bounds. This may not even be explicit pressure to keep up with friends but may start as a subconscious thought when they see their friends entering homes, and they realize that the same opportunity may be available to them, as explained by a housing counselor:

> Their friends are getting homes. They heard somebody got into the down payment program, and they came, and they weren't even thinking about buying a home until they heard their friends had one, and their friends say, "Hey, go ahead and get one too."

The need for instant credit or for instant gratification was also offered as an emotional stimulant. A financial counselor related an instance in which a client had just come out of bankruptcy, and in spite of her destroyed credit she immediately entered the homebuying market. The educator explained that this client was not deterred at all by high interest rates, she just wanted a house immediately, in spite of any long-term consequences. Even the initial consequences were quite severe as she entered 100% financing, the first 80% at double the prime rate and the last 20% at quadruple the prime rate. It is little wonder this client was previously involved in bankruptcy; she seemed addicted to the emotional joys of instant credit.

Financial characteristics of borrowers. Financial characteristics of borrowers also play a role in a borrower's susceptibility to unfair lending practices. A financial educator explained that in addition to the instant credit mentality described above, people seem to lack the financial skills even to manage credit or to rehabilitate damaged credit. Other financial characteristics that contribute to vulnerability include a lack of savings, low- or moderate-income status, and, of course, those with large amounts of equity in their homes such as elderly adults discussed previously. But as an education coordinator explained, "[What is important is] not just [being] educated as far as everyday literacy, but financial education." Even very bright and well educated people have become victims simply because their financial skills are inadequate.

General understanding of the mortgage market. Overall, Utahns lack financial literacy, and even a general understanding of the mortgage market. Many, especially first-time home buyers, enter the mortgage market optimistically but lack the experience and education to undertake the complexities involved in a home loan transaction. One participant involved in regulation illustrated:

> The people who [are exploited are] . . . the unsophisticated consumers who otherwise are not in a position to protect themselves, either because they are unsophisticated or not knowledgeable about how the market works, or what they may be getting themselves into. And that may be because of . . . the level of education or experience that person has.

Even those who feel they are ready to undertake a home loan transaction can find themselves lost in inches of paper work, much of it comprised of legal disclosures that are designed to protect the consumer. The more paperwork there is, the less likely it is to be read, explained a regional lending manager who went on to say, "I would dare say a

very very small percentage of the population understand what they are signing, and understand the terms of their loan."

Research Objective Four: Factors that Foster Unfair Lending

Participants described that the factors and conditions that have led to the existence of unfair lending practices stem from three basic areas: industry conditions, public factors, and legal structure. Each of these factors is examined individually, and then overlapping factors are discussed.

Industry Factors

Market complexity. Market complexity was one of the most cited factors for the existence of unfair lending. The mortgage lending market is very complex and as a consequence borrowers sometimes have a tough time discerning the terms of their loans. One consumer advocate described that mortgages and real estate transactions virtually have their own languages, meaning that discussing mortgages and real estate can involve technical and industry specific terms that borrowers may fail to grasp. Especially when reading the required disclosures, borrowers have sometimes been known to read through entire disclosures and still enter into unfair loans because they simply do not understand them. Complexity of disclosures is greatly compounded by the quantity of disclosures that are associated with a single loan. Interestingly, the following comment came from one of the participants who is also an attorney:

> There are so many of them that disclosures are becoming meaningless. I heard somebody say, and I don't know this as a fact, but when you close on a mortgage, if you actually read every document that is prepared in connection with that mortgage, it would take something like 10 hours. And the last time I got a home

> mortgage loan we were in the closing for about 45 minutes. So it was just one document after another being laid in front of me and signing it, and I almost got writers cramp. And those documents were full of disclosures and I paid no attention to them at all.

Booming housing market. Additional factors contributing to the existence of unfair lending include the fairly recent market booms, and the swelling numbers of lenders trying to make their way in the market. Some of these lenders have become bad actors[5] who simply use the mortgage lending market as a tool for exercising their craftiness and greed, explained one regulator who shared, "It's just the drive for the almighty dollar. It's seeing an opportunity to make some money, and they are willing to bend the law as they see it, break the law, forfeit their ethics, in order to make money."

The market system. Still others do not blame the lenders as much as they do the structure of the mortgage lending system. They explain that it operates incorrectly, or that lenders and other actors have misplaced incentives and are more or less forced to be unfair in order to stay in business. An attorney explained, "The system is set up to incentivise people to do the most loans they can do. The whole system is set up on volume and I think that maybe pushes people to, in one way or another, be more greedy."

Participants also explained that the system flaws originate with investors, also known as the secondary market, through which actors are often rewarded financially for arranging very risky loans, even when those loans have no logical benefit to the borrower.

[5] The term "bad actor" was used by the U.S. Department of Treasury (2000) and other literature, as well as by participants in this study to describe all perpetrators in unfair loans, not just lenders. This could include appraisers, brokers, loan officers, real estate agents, and any other party that acts as a perpetrator of unfair lending actions.

Factors Related to the General Public

The experts discussed many factors related to the nature of the public, or borrowers collectively, that foster the existence of unfair loans. A large influx of minorities with a language barrier, increasing popularity of instant credit, a lack of community resources for borrowers, a huge push for homeownership for all, and the trusting nature of Utah borrowers, were all reasons cited why the public is so vulnerable to unfair lending practices. The clear majority of comments concerning public vulnerability actually concerned the general level of awareness. When asked about educational opportunities for potential borrowers one finance educator conveyed, "The education is there. . . . I think it's available, it's just people knowing. Knowing, not just that it's there, but also knowing the value of it is huge."

Additional public factors that the participants were concerned with were the high rates of foreclosure and default, which not only lead to a pressing need to refinance, but also lead to tarnished credit histories, leaving fewer options and higher rates for these homeowners when it comes time to refinance.

Legal Factors

For the most part, participants also agreed that the legal system was at least partially to blame for conditions that allowed unfair lending practices to occur. Yet there was little agreement on what exactly was wrong with the system. Approximately half of the participants claimed that the legal system was too relaxed, especially with usury rates and caps. The other half, however, felt differently, that there were too many laws, or that

laws were too complex to be useful, such as the case with the numbers of disclosures described above.

Accountability. With current laws it is often times difficult to hold market actors accountable for their actions, whether good, or bad. The majority of the participants felt that licensing of market actors was a better approach for increasing accountability than laws that specifically restrict practices or behaviors. In addition to licensing, participants believed that the problem is not that current legislation is inadequate, but rather, that the current laws are not adequately enforced. The former owner of a lending firm explained, "Utah is a state that just doesn't seem to have, well we have laws, and they are already on the books, they just don't seem to have any real teeth in the laws."

This lender continued, "I think that the Division of Real Estate does a good job with the few resources that are available to them." Additional comments supported this idea that the state's regulatory agencies do as much as possible but simply lack sufficient resources to effectively monitor lending activity in the state. Also voiced by participants is the idea that the current laws may be adequate, but the penalties for violations of these laws are not. On penalties that are currently on the books, a lender described:

> The only thing you could do is spank the realtor on the hand, and slap him with a $500 fine, which I believe is the maximum, or at least it was when I worked there. And [for] the appraiser [it] would be $1000 and the maximum you could get out of a lender would be $2500.

Borrowers can lose tens or even hundreds of thousands of dollars, and even their homes, as a result of bad loans. Similarly, market actors are sometimes able to finagle tens or hundreds of thousands of dollars from a single borrower. The current penalties as

described by this lender hardly seem sufficient to deter unethical market activity among actors who simply see these fees as a cost of doing business.

Jurisdictional boundaries. Penalties do not serve as much of a deterrent to would-be perpetrators of unfair lending, but in addition, the chances of ever being caught in the first place are in reality, quite slim. This is partly due to the structure of the legal system, or rather the structure of jurisdictional boundaries of the regulatory bodies involved in home-based lending. Jurisdictional boundaries are perceived as very confusing and unorganized, and have been blamed for causing many instances of unfair lending to "slip through the cracks." When asked which regulatory body was in charge of regulating second mortgages one neutral participant replied:

> It may not fall under anybody's. The Division of Real Estate regulates first residential mortgages by nondepositories. If they do commercial loans [the Division] doesn't regulate it, if they do second mortgages [the Division] doesn't regulate it. You get something like the loan fraud that we saw a few years ago with Fairbanks Capital, [the Division] didn't regulate that because they don't regulate servicers. That comes under the Department of Financial Institutions. When I say they don't regulate it, I don't want you to get the impression that that's something that they choose, but that by statute, it's not given to them to regulate.

One participant described instances in which several industry actors were not even aware of which governing body regulated their particular areas of business. Table 4 was developed by one of the participants during an interview to describe the division of regulation and the types of lenders and the impacts of this structure of organization.

Though this table explains the division of jurisdiction a bit more clearly, it does not adequately describe who regulates second-mortgage lenders, home remodeling financers, home equity lenders or others who do not fall directly into the categories of

Table 4

Division of Regulation and the Types of Lenders

Regulated by:	Department of Financial Institutions	Division of Real Estate
Classifications:	Depositories (Banks, Credit Unions or affiliate)	Nondepositories
Mortgage Banker (Owns the mortgage note) Has regular audits.	Larger banks such as Wells Fargo and Zions. Most regulated group. (Least amount of predatory loans)	Closes loans in their own name and then sells them off to the secondary market.
Mortgage Broker (Never owns the mortgage note) Does not have regular audits.	May be a small community bank that does not hold loans in their own portfolio.	Never owns the paper and doesn't have deposits. Least regulated group of all. (Most predatory loans)

depository and non depository. Several participants emphasized that the issue was not a deficiency in the abilities of the state's current regulatory bodies, but rather a lack of adequately defined areas of regulation. The experts explained that in jurisdictional issues the state has little control because the divisions of authority are often passed down from the federal level. This concept was explained by a participant with over 20 years experience in the market:

> They actually attempted to do universal licensing in Utah. The federally chartered depository institutions said, "Hey, do what you want. License away! We are a federally chartered bank, we're subject to federal laws, and so if you pass all this licensing stuff we're going to claim federal preemption. So put all the

> restrictions that you want on yourselves, we're going to be exempt because we're federally chartered." This is one of the reasons for the division of regulation of mortgage lenders in this state between the Division of Real Estate for nondepositories and the Department of Financial Institutions for depositories.

Overlapping Factors

Some of the factors discussed by the participants seemed to have an overlapping nature, or had an influence over more than one of the previously described areas. For example, according to several participants, the lack of accountability in both the industry and the public have led to conditions that foster greater unfair lending activity. "There is responsibility on both sides," one educator admitted. Ignorance on the part of consumers and greed on the part of the lenders too often goes unchecked, and that combination of conditions has led to most occurrences of unfair lending, according to one lender.

Obstacles to victim redress. Participants also felt that there were many obstacles that prevented consumers from receiving adequate redress once they had been victimized. This can be seen as a legal problem or a consumer awareness problem depending on the situation. According to a regulator awareness of avenues for redress is an issue, "They may not know that they can or where to go." This certainly makes sense considering the jurisdictional issues discussed previously. If some industry actors are not even aware of what regulatory body has jurisdiction over them, it stands to reason that a borrower would find it difficult, if not impossible, to lodge an official complaint against such a company.

Even those who do manage to lodge complaints rarely see effective results according to a consumer advocate who said, "So everyone asks me, 'Well why bother

going through all this? Why give you all my information and talk to you when you can't fix it?' And you can't, you can't fix it. Very rarely. And that's been my experience."

Lack of resources for prevention and reparation. The lack of resources can be viewed as a legal or a consumer issue. Lack of resources is indeed an obstacle for regulatory bodies as discussed previously. Beyond legal resources, educators and consumer advocates also lack resources specifically for prevention of, and reparations from unfair lending. On preventative measures one educator explained, "The problem is funding. If we had enough funding we could offer these classes for free and attract a lot more people to come." As far as recovering losses from instances of unfair lending, participants explained that it usually requires the services of an attorney, but the costs of these services can easily outweigh the potential benefits, as one attorney explained, ". . .is it worth going after them? . . . An attorney who has to earn a fee off of [the case] is not likely to sue them." But it is clear that whether it be for consumer education or for tracking down and prosecuting bad actors, there are just not enough resources available for prevention of and reparations from cases of unfair lending.

Pressure to arrange bad loans. Large amounts of pressure and emotion on both sides leads industry actors and consumers to arrange loans that are not economically logical. An owner of a lending firm explained that lenders face pressure from all different areas:

> Sometimes I think pressure is self-imposed by a loan officer that's making a loan. Perhaps they've told people all along, "Hey, this loan looks good, no problem." And some kind of a problem comes up toward the time a closing is approaching and people have literally boxed up their house, and have moving vans going and all of the sudden there's a problem. . .

Lenders can face self imposed pressure, to earn profits or simply to satisfy the borrower. Borrowers can also be very emotionally charged for many reasons, but often a primary reason is simply the magnitude of the financial transaction. The lender explains:

> For most people it's the largest financial transaction they've ever made, so there can be a lot of emotions that come into play. And people sometimes act in ways they wouldn't normally act because of the pressures involved with deadlines, money involved, and all those kinds of things.

Lack of measurement standards. Pressure and emotion on both sides of the transaction can create prime conditions for the arrangement of "economically illogical loans," a neutral participant observed. The lack of a consistent and accurate measurement standard has made it impossible to identify what constitutes an economically illogical loan. This is yet another factor that has allowed unfair lending to persist, because occurrences can and often do remain undetected by all parties including borrowers, lenders and even legal enforcers until it is too late. Due to this lack of standard measurement, unfair lending is currently treated on a "case-by-case basis," described a directing member of a national lending firm.

Summary of Objective Four

There were four general categories for the factors and conditions that fostered the existence of unfair lending in Utah: industry, public, legal, and overlapping factors. Participants indicated that irresponsibility and lack of accountability persists on both sides of transactions. Participants also explained that the mortgage lending market is complex and vast, and lenders and borrowers alike often face conflicting incentives, due to current market structure. Additionally there are serious jurisdictional issues and

certain types of lending occur without any government regulation, leading to many difficulties including lack of adequate victim redress.

Research Objective Five: Practices

In the following story related by a lending counselor, there are roughly seven practices mentioned that have been defined by one or more interview participants as unfair lending practices:

> I'll tell you a story. In rural Utah there was a family that was qualified for a loan that was way more than they could afford, and . . . just pushing those ratios to the max. . . .It was a balloon payment. Knowing that it could not succeed, the lender put them in it anyway. . . . It was adjustable rate which is fine under certain circumstances, but with a lender who knows that they've already stretched the ratios as far as they can. . . And then, the second that rate goes up, they are just going to break the family. And then putting that prepayment penalty so there's no way they can get out. You also see that realtor-lender group . . . . that they put you in hoping that it will fail so that they can buy the house and resell it to somebody else who can fail, and make tons of money on both ends of it.

In general, unfair mortgage lending practices that result in a negative effect on a borrower can be divided into two distinct categories: unfair actions on the part of bad actors, and unfair loan features. Before introducing the rest of this section a point that can not be overemphasized, and with which most participants agreed, is that many of these actions or features do not, by themselves, necessarily make a loan predatory, abusive or unfair. It is the case, however, that each of the practices or loan features discussed in this section has at one point been used, and has been at least partially to blame for an occurrence of unfair lending. Each unfair action and loan feature is discussed with supporting evidence offered by the experts.

Unfair Actions

100% financing. One industry advocate, one consumer advocate and one neutral participant described that 100% financing can be a good thing, and is often directly supported by government sponsored or non-profit consumer agencies. Yet, they feel that it is often misused, especially when arranged directly by lenders. The first 80% is often several points above the prime rate, which isn't necessarily harmful, but the last 20% will often be financed at a 20% interest rate or even higher. According to these participants, this creates a harmful situation with the borrower living in an unaffordable house with unaffordable payments.

3-year cycle of loan officer employment. One participant with extensive experience in the banking industry explained what she called, a "3-year cycle." The 3-year cycle entails dealing with a loan officer who attempts to evade internal audits that are conducted regularly by depository institutions. This person offers high priced and abusive loans, and after about 3 years the loans made by this officer will start failing and going into foreclosure. By this time, however, the loan officer has moved to another company and started the process all over again. The new company is not aware of the behavior of these officers; in fact, when they hired him and talked to Human Resources at his former company, he was often characterized as one of their top producers. This eventually leaves the borrowers and the banks with the bad loans, while the officer is free to continue earning large commissions.

Bait and switch. Bait and switch practices were only explicitly discussed by one consumer educator, though it was implied by many other participants. Bait and switch practices involve luring in borrowers with promises of low rates and fees, sometimes

even on written good faith estimates, but changing all of those figures to higher rates at the time of closing. Many borrowers are so emotionally involved and under pressure at the time of closing that they will sign the documents anyway. The educator admitted that borrowers need to be more responsible, and not to sign under those circumstances, but that many borrowers are just not aware of their rights in those types of situations, and are sometimes threatened and pressured into signing.

Lending cannibalism. Lending cannibalism captures the idea that minorities use their commonalities such as language and culture to prey on borrowers of their own ethnic background. Two consumer advocates and one neutral participant explained that this is a common occurrence. The neutral participant explained:

> I've seen Hispanics taking advantage of Hispanics. That seems to be the biggest national origin group that's doing that. It will be a Hispanic realtor, Hispanic lender, and sometimes even the insurance company, are all in cahoots together, or have one company that they go to and they package the whole deal.

Criminal conduct. Criminal conduct, explained an attorney, can range from complete fraud, to failure to disclose proper terms, or failure to give a good faith estimate. A neutral participant explained that these activities are illegal and are certainly unfair, and harmful.

Equity based lending. Two consumer advocates and three neutral participants explained that equity based lending is quite common. This includes qualifying a borrower for a loan based on equity and not income. Equity based lending can also involve equity stripping through repeated refinancing, and often happens to elderly adults because they usually have large amounts of equity that has been built up over the years.

Misleading information. Two industry advocates, two consumer advocates, and one neutral participant discussed misleading information as being particularly harmful. A neutral participant explained that this is a gray area but is certainly harmful:

> To mislead somebody about what those terms are, would again, with the intent to get them into a loan that if they really understood those terms, a reasonable person . . . would not enter the transaction.

Scheme to steal from borrowers. Two neutral participants explained that many times actors are not really in business to make money legitimately but are simply using lending as a means to steal. One shared:

> But the real predators are the ones that not only sell a package that is not good for you, but they sell you a package and then roll it two or three times to the point that the fees have been jacked so high, that they intend to really steal the property. That's a real predatory thing.

Multiple salary qualification. One consumer counselor explained that she sees many loans that were arranged based on multiple salaries, or using the combined income of all residents in the household. Sometimes the income of a temporarily residing relative is included. This can be harmful as she explains:

> But when one guy moves out, they don't have enough money any more, and there are just too many people on the loan, too many salaries being considered, which is really going on here a lot. Every minority that comes in for default counseling has a [multiple salary] loan.

Flipping. Flipping, discussed by two consumer advocates and one neutral participant, is basically repeated refinancing of a home, often with the intent to strip equity. The perpetrator will usually set the monthly payment amount deliberately high so that the borrower cannot make the payments. And when they cannot make the payments, they will refinance, and while the monthly payment might be a little lower, the perpetrator will make large profits from the closing fees of the original loan and the

opening of a new loan. The perpetrator can do this until the equity is entirely stripped and the borrower cannot afford the fees to refinance, leading to foreclosure.

Abusive servicing. The day to day responsibilities of collecting payments from the borrowers are often sold to third party collectors known as loan servicers. According to one consumer advocate and one neutral participant, there are unfair practices occurring in the servicing market. Servicers have been known to add bogus fees, intentionally hold payments to earn late fees, and to frequently lose payments. According to a consumer advocate, servicers require complaints and disputes in writing within 30 days, but do not tell the borrowers this, often leaving the borrower unable to address any problem on their account. These unfair servicing penalties can add up, as a consumer advocate shared, "I just saw one the other day and it was $9,000 more added to their principal."

Steering. Steering, according to one participant from each category, is leading a customer to a higher cost product than they would really qualify for. This could involve actively steering a customer to higher rates, or a subprime lender omitting or hiding from a borrower with good credit that they could get a better price with a prime lender.

Unaffordable lending. Unaffordable lending, according to a consumer advocate is, ". . . just pushing those ratios to the max." The ratios referred to include debt-to-income ratios, and loan-payment-to-income ratios. Mortgage lenders often use such ratios to determine the credit risk of individuals, but often push the debt-load and monthly payments as high as possible. This can also be facilitated by down payment assistance, or loans from relatives, "And then it just snowballs from there." Three consumer advocates, two industry advocates, and all four neutral participants commented that unaffordable lending is a common unfair lending occurrence.

Preying on vulnerabilities. According to the neutral participants, two consumer advocates, and one industry advocate, unfair lending involves the act of preying on specific characteristics of vulnerable borrowers in order to use one or more of the listed unfair actions or loan features to increase profits. One neutral participant explained, "It is somebody out there who is not looking for a typical borrower. They are looking for someone who is in very extreme circumstances, so they can take advantage of them."

Abusive networking. Two consumer advocates, one industry advocate, and one neutral participant explained that actors will sometimes network and consistently cooperate with the intent of taking advantage of a borrower. One consumer advocate explained:

> I always say that, "like" people get together. Often the loan officers have "like" appraisers and real estate agents and they will continue to work together through the years and through different companies. They become very good at working as a team to rip people off.

Overappraising. A key part of abusive networks is arranging overappraised values of properties. This creates a real problem when borrowers attempt to refinance or sell, and are unable to achieve the original purchase price of the property.

Unfair Loan Features

Adjustable rate mortgages. Adjustable rate mortgages (ARMs), like so many actions and loan features, are not inherently unfair in and of themselves, but are often misused according to two industry advocates, one consumer advocate, and one neutral participant. One lender elucidated:

> For example, and this is a personal bias, because you can talk to people who think ARMs are the greatest thing since sliced bread. But I particularly have issues with option ARMs. Those are the loans that you've heard about on the radio or

> seen on the billboard that advertise a 1.9% interest rate, or something that is dramatically lower than what the market interest rate is.

Teaser rate. Similar to ARMs, teaser rates are frowned upon by two lenders in the study. One lender explained his views:

> A lot of times they will have a teaser rate on the front end, and then they'll have negative amortization or they'll have a six month introductory rate. A [borrower who is somewhat behind on his current loan] is thinking, "Oh my heck, I've got to get these two payments made or my house is going to go," and [the borrower] is not thinking about what's going to happen to [him] six months from now. And so these guys will suck [him] into a teaser rate, and then they'll whack [him] with a higher rate.

Balloon payments. According to two consumer advocates, one neutral participant, and one industry advocate, the inclusion of a balloon payment can be very harmful because it can make the payments in a loan artificially low and prevent equity from accumulating. One attorney explained, "The balloon payment is one way, when somebody is struggling along making payments, all of the sudden you can slam them with a balloon and that's when you can go in and grab the house."

Credit insurance. Credit insurance described by one neutral participant is usually not beneficial to the borrower, and is sometimes hidden and financed within the loan, and is simply another way to earn more profits from a borrower.

Financed fees. Credit insurance is not the only charge that is financed into a loan; if borrowers are unable to pay for fees up front, it is not uncommon to have them rolled up into the loan. This leads to the long term interest charges not only on the loan but also on the fees in the loan. One lender in the study saw this as particularly unfair.

Hidden charges. Often the credit insurance and other fees are rolled into the loan and the borrower is completely unaware of it. One neutral participant explained that this

practice is unfair and abusive, "And a lot of times, they kind of hide it. You don't even know you're getting it, and it really doesn't do much for you, and it can add a good $10,000, $15,000, or $30,000 into your loan."

High fees. Two industry advocates and two neutral participants agreed that high fees are simply a problem. One neutral participant explained, "If the interest rate doesn't do the person in, the fees will. It can add anywhere from a couple thousand to $10,000 to $15,000 into their loan."

High interest rates. High interest rates can be extremely detrimental to a borrower according to two neutral participants and two consumer advocates. A neutral participant explained, "Again, the biggest thing is high interest rates, way above whatever the normal rates are. Lets say ours are around five or six right now, they'd be anywhere to 8 to 12 to 15, 16, 18 percent."

Interest only loans. One neutral participant explained that interest only loans are often misused, "Paying interest only, your payment would be lower so you could pay more for a bigger home. People get into houses that are way over their heads. I think those should be illegal, but again that's my opinion."

Prepayment penalties. Two lenders, two neutral participants and one consumer advocate explained that prepayment penalties are frequently misused and often prevent borrowers from being able to refinance out of the bad loan situation. When other abuses occur in a loan there may be no escape, according to one neutral participant, "There was a prepayment penalty . . . so there's no way they can get out."

Research Objective Six: How to Reduce Predatory Lending

From the previously shared evidence it is abundantly clear that unfair lending practices are widespread, are perpetuated due to numerous factors, involve an inestimable amount of specific practices, can happen to nearly every class of person, and affect nearly everyone to some degree. It is also abundantly clear that because of the complexity of the problem, there are no quick and easy solutions. Therefore, any serious attempt to reduce the occurrence of unfair lending practices requires a full awareness of all parties involved, a clear understanding of the implications of actions, and a long term commitment. The remainder of this chapter is devoted to sharing the thoughts and opinions of the 12 mortgage market experts on what can and should be done to reduce the occurrence of unfair lending practices in Utah.

Legislation

Prohibitive legislation not effective. A popular sentiment among consumer advocates across the nation is that the major flaw is a lack of protective legislation (Engel & McCoy, 2002; Quercia et al., 2004). Several participants agree that as far as prohibitive legislation goes, "There could be room for improvement." But most participants either explicitly or implicitly suggested that attempts to legislate unfairness out of the system have not been very effective, and may have even caused more problems than it solved. Several stories were shared about other states that decided to crack down on unfair lending with heavy handed legislation, only to find that instead of cooperating, lenders just pulled out of the state and refused to do business there any longer (Downey, 2006). Participants admitted that some of the lenders who left were likely perpetrators of

unfair lending, but explained that the majority were simply serving their clientele. Overly aggressive legislation can have many adverse consequences, explained an expert on regulatory issues:

> Well, Georgia for example passed an aggressive predatory lending law . . . but that whole segment of the population was cut off from access to mortgage lending. . .So you can get into some of these areas and really have a lot of unintended consequences that cause a lot more harm than good. And you have to look for that balance.

This participant went on to explain that "What most legislators don't understand is they have no control over the financing of mortgages. This is a national market and it's controlled by investors." In other words it may not even be in the hands of the mortgage lending companies; if costs of complying with aggressive legislation are too high, investors will demand other avenues of investing. In short, it is much too difficult to separate the unscrupulous lenders from the legitimate lenders based simply on prohibitive legislation because, as described in section five of this chapter, most actions and loan features are not inherently unfair, they simply become unfair when they are misused. While unfair lending is certainly a problem "you can't let the tail wag the dog" as one participant explained, meaning that legitimate lending should not be hampered in attempts to curb unfair lending.

Increase accountability. A better legal approach, according to the officials, is to increase methods of accountability of market actors, such as licensing for lenders, brokers, appraisers, and real estate agents. Licensing and registration requirements officially began in Utah in early 2004, and one counselor described that "This has made a huge difference." Unfortunately licensing has not become a panacea. Though licensing can increase accountability, or the ability to locate perpetrators of unfair lending

activities, there is usually little that can be done as a consequence for unacceptable practices. A former president of a mortgage company explained:

> All they can do is take their license. When they find somebody real bad, they take their license, but they really ought to be prosecuted. I mean giving up a license and walking away with ¾ of a million dollars in mortgage fraud. . . I'd sell you my license for ¾ of a million dollars. It's just a cost of doing business for them.

Another method of accountability that has been recently introduced to the state of Utah for nondepositories, is the assignment of Principle Lending Managers. One lender explained that each nondepository will be required to have a principle lending manager who is responsible for each person in the company. The idea is to create greater incentives for companies to police their own employees, and to ensure fair lending practices. This is generally seen as a positive thing among participants.

There are also continuing education requirements for lenders in Utah. This method is also thought to viewed as a method of increasing awareness and accountability according to one lender, "Hopefully, licensing originators and requiring continuing education, hopefully that helps people be better at their job." Yet increased accountability through licensing, Principle Lending Managers, and continuing education, is only effective as long as penalties for unfair lending are adequate. Officials felt that penalties should be harsher, and therefore more of a deterrent. When asked about legislation, one lender explained that the ability to enforce existing laws is important:

> Enforcement. Enforcement of the laws that we already have on the books. . . .I think they ought to be slapped with the absolute maximum fine. You'll hit me in the pocket book and I might pay attention to the rules . . . . But a $400 fine isn't going to stop me from doing whatever.

Geographical tracking. An education center manager suggested a legal provision to allow regulatory bodies to better track geographical patterns of indicators of unfair

lending, "More cognizant scrutinization is needed in areas with rapid growth, and with more closings. These areas are likely to experience higher proportions of abuses." This would help to identify pockets or epidemics of unfair lending, which are often concentrated in such neighborhoods.

Improve victim redress systems. But, in order for any method of lender accountability or neighborhood identification to be effective, consumers certainly need adequate avenues for redress. As explained in the section on factors, even once consumers realize they have been victimized they often have trouble carrying their injustices to the next step of redress. There are multiple reasons for this, (a) borrowers are not aware of their rights and what they should do to obtain redress, (b) due to jurisdictional boundaries and lack of awareness, borrowers do not understand where to go with concerns and complaints, and (c) even when borrowers manage to file appropriate complaints, there is often little retribution that ever comes from it, due to lenient penalties at both the state and federal levels.

Mandatory education for borrowers. To avoid ever needing a system of redress, several participants argued for mandatory counseling and education before borrowers are ever able to enter in to a loan. This would serve as a preventative measure, and ideally would help the borrowers themselves weed out the more harmful and unethical market actors. A former community development lender explained:

> It should be mandatory . . . I can't stress enough that everybody before they get a mortgage should have homebuyer education. Just to know what they're buying, how to figure out which mortgage is the best, what interest rates are the best, points, fees, all the different varieties of things that go into acquiring a loan. Just so they have an idea of what the whole process is.

Bridge jurisdictional boundaries. As described previously, participants emphasized the role that jurisdictional gaps play. Several participants mentioned the possibility of the creation of special positions for prosecutors who could take legal action on cases of mortgage fraud regardless of state jurisdictions involved. However, the best, and perhaps only way to effectively bridge the gap according to sources, is not action at the state level, but rather at the federal level. One lender said, "I think it would be reasonable to do predatory lending laws, but in my opinion, they absolutely have to be done on a national level." But whatever legislative action is taken in the future to address unfair lending, several participants offered a subtle warning similar to one offered by a lender, "Anything that is done from the legislative side has to be done nationally and has to be done very cautiously so you don't mess up the system that has served our country so well."

Community Support

Community support is a vital component in the fight against unfair lending. One consumer advocate related that word of mouth, and neighborhood support can go a long way to increase awareness of potential borrowers. "Just people in general supporting each other," she explained while also admitting that this is something that is very difficult to control or encourage.

Fair housing committees. Other resources that would be very helpful are fair housing committees that can act as advocates and resources for victimized borrowers. There have been talks of such committees that may have begun to materialize but nothing

concrete has yet come forward. One such committee that is in the works was described by a consumer advocate:

> It's the Utah Anti-Predatory Lending Initiative. It consists of the Better Business Bureau, Community Development Corporation of Utah, America First Credit Union, Legal Aid Volunteers, Eileen Walker housing trust fund, Utah Mortgage Lenders Association, Utah State University, and AARP volunteer corp. Fannie Mae is heading it up.

The purpose of the committee is not only to define the problem but also to create a comprehensive solution to individual cases. This solution includes legal action, counseling and education, credit rehabilitation programs, as well as alternative financing options to help the borrower get out of the bad loan as quickly as possible. These types of groups show potential but require widespread cooperation of non-profits and lenders, and large amounts of funding.

Neighborhood revitalization programs. An additional form of consumer support can be found in neighborhood revitalization programs targeted specifically at vulnerable neighborhoods. Some neighborhood revitalization committees already exist in Utah, though on relatively small levels, according to one participant who has had experience working with them. In spite of their small size, the participant felt that they were very successful at helping revitalize the skills and abilities of the residents in some of the most vulnerable neighborhoods on the west side of the Salt Lake Valley.

Change Industry and Borrower Incentives

According to the mortgage market experts, there are two things that would help to put correct incentives in place. For the industry, it is a more vigorous self-policing of

their own actors. For borrowers, it is getting them interested in education for their own sakes.

Rearrange industry incentives. Loan officers and brokers lack an incentive to be concerned with a customer's long term well-being. That is to say, they lack the financial incentive. Participants agree that most mortgage market actors: appraisers, loan officers, brokers, real estate agents, and others, are very honest and ethical people, and that their own standards of ethics and morality are enough to ensure interest in a customer's long term well being. It is not the average actor that becomes an unfair lender, but rather the ones who operate strictly on financial incentives. Though perhaps sad commentary on our society, it is apparent that an increasing amount of bad actors are concerned only with financial incentives. Participants were not able to name specific ways to rearrange incentives, but suggested that it is possible, and worth investigating further. Perhaps larger and more frequent penalties for unfair loans, either derived legally or through the industry itself, or perhaps less up front commissions to brokers and more long term rewards for stable loans, would ensure a broker's interest.

According to one lender, there needs to be more, "Relationship selling," and they need to be in it, "for the long haul." One financial educator explained a relationship arrangement in some other states that seemed to help:

> There are states that have a realtor-home buyer education relationship, where, when [the realtor] enters into a contract with them he sends them to a home buyer class so that they're educated and then once they get into the process they know what they are doing.

Rearrange borrower incentives. But lenders and brokers are not the only ones who lack incentives for long term stability of loans; borrowers themselves allow, and

sometimes even encourage unfair loans just so they can get into an unaffordable house. More often than not, these situations occur because borrowers are not fully aware of the consequences of such loans, and therefore lack any incentive to prevent them.

Consumer awareness is likely much easier to address than changing the incentives of lenders, yet relatively little has been done concerning awareness campaigns for educating borrowers. So far awareness and education campaigns have been largely headed up by non-profit, and grant funded institutions that are too often understaffed, and unable to reach the hundreds of thousands of potential borrowers who are in need of their services. As one industry advocate announced near the end of the interview, "Consumer education is paramount."

Financial Education

Since the late eighties when unfair lending practices began to proliferate there have been people pointing fingers at others, and blame and responsibility for the problems cast in all different directions. The industry, for example, has been criticized immensely, and perhaps rightly so because that is the origin of the vast majority of the bad actors, and perpetrators. The legislature has been blamed as being too relaxed or too tight or not quick enough, and not concerned enough. Again there is likely some truth to these statements as well.

Still, the only issue addressed and emphasized by every single participant in this study as an effective method of reduction is the arrangement of comprehensive financial education of every consumer. This method of consumer protection has of course been recognized in previous literature but has rarely been accentuated as the main, and best

method of consumer protection. Yet, according to participants, the importance of this method of protection cannot be overemphasized. In fact when one neutral participant was asked near the end of the study what should be done to reduce predatory lending, she simply replied, "Education, education, education."

Homebuyer education. Homebuying classes are an immediate solution, and a way for consumers to be educated about the process before buying a home. One homebuyer counselor asserted "Number one is that consumers need to be educated, through buyer education courses where predatory lending is covered in detail." But these courses are often limited to a single day, and some feel that they simply need more time to truly educate a borrower. A housing specialist shared, "I think it needs a little more time . . . We go fast and hard, and try to get everything in that is going to help them."

Another drawback, particularly to home buyer education, is optimal timing of courses. Several educators complained that by the time some of the borrowers were involved in the class, they were so deep into the buying process that many wouldn't cancel the transaction even if they realized it was a bad loan. One homebuyer educator explained that whenever possible her organization tries to catch people before they enter the home buying process:

> We would love to have people come just because they're interested in buying a home. That's our ideal home buyer student . . . because they go in fully armed and ready, and once you call a predatory lender once or twice on what he's doing, he stops. He stops, because he knows you're educated and he's not going to mess with you.

Awareness. Borrowers might be more apt to come in for the education if they were more aware of it. For most consumers it is an awareness problem; not only awareness of educational opportunities and other resources available to them, but also

awareness of the potential dangers or pitfalls they could encounter as they enter the homebuying market.

Resources. Educators typically direct most of their resources to education materials, leaving little in the way of advertising. An educator described the limits in advertising:

> Because we run on grants, we don't use our money for advertising very much. We're just now working with the city to put it in their city newsletters that go out with the bills and stuff. And that's helping, and every once in a while we get a free space in the local newspaper and we usually get a lot of calls on those.

Formal advertising in the media was cited by others as an extremely effective tool, but was simply too expensive. When asked about resources, several consumer educators cited the U.S. Department of Housing and Urban Development (HUD) and non-profit foundations. One participant speaking about certain mortgage lending companies explained that they had the resources to fund "world class financial education courses," yet very few were cited as direct sources of funding for these institutions. However, because the industry also stands to gain through having a "mortgage-ready-borrower," several participants suggest that the mortgage lending institutions should be required to direct a portion of their funds directly to these non-profits for purposes of education.

Shopping. Even if consumer education courses were fully funded, and each borrower was informed, educated, and prepared to enter the mortgage lending market, the real homework would only be beginning. Consumers need to shop, compare and make informed buying decisions. "If consumers would get three good faith estimates prior to entering into a mortgage, the number of predatory loans would go down significantly, but

they don't," explained one attorney. Even those with bad credit will have options if they really take the time to shop. Borrowers with bad credit can also work on credit rehabilitation so that their future shopping options become better. The idea of shopping, however, is not without its shortcomings and can become complicated particularly in cases when networks of unethical actors, including realtors, arrange the financing in behalf of the borrowers.

Financial education in the schools. As good as homebuyer education may be, the experts admitted that it was only a temporary solution to a much larger problem: a general lack of financial literacy among all Americans, including Utahns. One educator exclaimed:

> I think everyone should be required to have personal finance classes before they are out in the world. It's basic education that all high school seniors or juniors should have.

Several participants mentioned that beginning in 2007, all high school students will be required to take one-half credit of financial education. While this is certainly a step in the right direction, it is only the beginning, according to one neutral participant, because financial education should be a core requirement, and in her opinion it is "more important than algebra." When asked to clarify, this participant explained that students are required to know algebra in order to graduate, but are not required to know how to balance a checkbook, interpret a loan document, or understand credit. When asked to rate the importance of financial education this expert replied:

> A ten in my opinion on a scale of one to ten. Everybody has to go get a job, everybody is going to have credit of some kind somewhere or another down the road. Everybody is going to have to pay for things, get money and pay for things. Balancing a checkbook is a simple thing but I got to tell you there's a lot of people who don't have a clue how to do it. I don't know how you manage in life

> without having some financial literacy. Now Algebra I would say one in ten might use it once they get out of school, but real life finances, everybody."

Consequences of Unfair Lending

Determining the consequences of predatory (unfair) lending was not originally an objective of this study and was therefore not included as a question during the interviews. Nevertheless, participants saw fit to add a great deal of information concerning this topic. The fact that participants were able to adequately address an additional topic that was not explicitly solicited serves as an additional verification of the validity of this study for describing predatory lending issues. In other words, it is probable that had other objectives been overlooked such as determining victim characteristics or suggestions for reduction, these topics would have been discussed by the interviewees anyway. This section covers the material shared by participants concerning the consequences of unfair lending.

The consequences of unfair lending can be numerous and far reaching. The industry itself is hurt by its own actors. First, an industry advocate stated that, "Consumers are less comfortable meeting with their loan officers," and also that, "They're intimidated by the process." The whole industry suffers because of the actions of a few. When approached about this topic one lender illustrated:

> That's why laws are made. That's why there are laws about bank robbery. The average person doesn't commit bank robbery but there's the law forbidding bank robbery because there are a few people who go out and do it. And it's the same thing with our mortgage laws. If everybody would just be straight up, and look out for the best interest of the customer, the borrower, we wouldn't have so many regulations.

Industry actors are not the only ones who suffer losses; everyday investors in mutual funds, life insurance policies, retirement funds and other investments also bear some of the losses. One 20-year veteran of the market clarified:

> So, if fraud is committed on a loan, and that loan is sold to an investor, and because of the fraud, at some point, that loan defaults, then it's that end investor that potentially takes the huge hits. I mean, and those hits can be substantial.

Foreclosures and bankruptcies are quite frequent consequences as a public affairs specialist related, "The consequences are numerous and far reaching. Foreclosures and bankruptcies are the most common consequences." Borrowers are not the only ones who suffer losses from foreclosure and bankruptcy; neighboring property values can be affected, and taxpayers, as usual share some of the costs. A former banker explained:

> There are other economic impacts which have a ripple effect. They take away time from other developments, take up staff time, sheriffs sales, bankruptcy proceedings cost staff time and tax payers dollars.

This participant continued to expound that the ripple effect described above eventually has an effect on the overall economy. The home buying market is vast and influential, and problems in that area can play a large role in the rest of the economy.

Unsurprisingly much of the costs of unfair lending practices are passed right back to the borrowers in numerous ways, such as higher priced lending products, including higher interest rates and fees. Yet, as bad as all of these consequences may be, they pale in comparison to the consequences that face the victims. A lender explained why the consequences can be so ruinous:

> There's probably a lot of people that may have had predatory abuses in buying groceries, or cars, or furniture, but it's not life changing like it can be on a mortgage, because that has a substantial financial effect on people. . . . And I think that's why mortgage lending gets so much attention.

Summary

Twelve professionals from the mortgage lending market in Utah, included four consumer advocates, four industry advocates and four neutral participants, were asked to define and describe predatory mortgage lending. Each subsequent summarized finding discussed is directly supported by comments made by the participants.

Definition

Predatory lending is the act of preying on or taking advantage of borrower vulnerabilities. While there are subtle differences between the terms predatory, abusive and fraudulent lending, participants frequently used these terms interchangeably. This implies that participants used the term predatory lending not only for discussing targeted acts or preying on vulnerabilities, but as an encompassing term for all lending abuses, including illegal actions. Similarly, the term "predatory lender" was not always used to refer to an actual lender but included any mortgage market actor such as an appraiser, a real estate agent, a servicer, or anyone who earns profits in the mortgage lending market.

Predatory lending as a vocabulary term in the mortgage market is frequently misunderstood because it regularly carries certain stigmas and slightly different meanings and connotations depending on the perceptions of the user of the term. The implication is that the term "predatory lending" is actually an obstacle to common understanding, and should therefore be discarded and replaced with another, more suitable term, that aids common understanding instead of becoming a hindrance.

While the participants did not explicitly suggest a replacement term, the less stigmatized and more encompassing phrase of "unfair lending" was used on several

occasions by participants to refer to predatory, abusive and fraudulent acts. Therefore, this was the substitute term used throughout the remainder of this paper. Similarly, the term "actor" or "bad actor" was used in place of the term "lender," to include all possible perpetrators of unfair lending.

Using evidence quoted by participants it was determine that unfair lending is one or more of the following: (a) a transaction without a fiduciary duty or having the borrower's best interest in mind, (b) a transaction the borrower does not completely understand for any reason including age, language barrier or lack of financial savvy, (c) a transaction that has no beneficial use or results in harm to the borrower, (d) a loan that delivers the lender excessive profits, and (e) a loan that the borrower does not have the ability to repay.

Because this definition lacks measurability, it was supplemented by further evidence offered by the experts in this study. Six additional topics were discussed by the participants and helped to further define and describe unfair mortgage lending.

Magnitude

Unfair lending practices have been known to occur in many places throughout the state, but have been specifically identified in St. George, the west side of Salt Lake Valley, West Valley City, Ogden, and Sandy, and the entire Wasatch Front. Nine of the 12 participants felt that unfair lending is a large and increasing problem in Utah. Many of the participants considered foreclosure, bankruptcy, and default rates as additional indicators of unfair lending practices, and because Utah has high rates in all of these areas it can be concluded that unfair lending is also very widespread.

Victim Characteristics

The victims of unfair lending practices are usually, but not always borrowers. Lenders and investors can also be victims, and occasionally even a co-conspirator in a fraudulent loan can become a secondary victim. Borrowers usually suffer much more severe losses than other types of victims, and justifiably received more attention of the participants.

Characteristics of vulnerable borrowers were separated into four areas: personal attributes, emotional characteristics, financial characteristics, and general ability to understand home loan transactions. Common personal attributes of victims were young, elderly, minority, non-English speaking, overly-trusting, somewhat irresponsible, and could potentially be anyone. Emotional characteristics of victims included feelings of desperation, desire for instant gratification, and real or perceived pressures from peers and lenders to go through with loans. Financial characteristics included a bad credit history, an instant credit mentality, low income, no savings, large amounts of equity in a home, and poor financial literacy skills. Utah borrowers also generally lack the understanding, experience and education needed to undertake the complexities involved in a home loan transaction.

Factors

There were four general categories for the factors and conditions that fostered the existence of unfair lending in Utah: industry, public, legal, and overlapping factors. Industry factors included market complexity, high levels of market activity, the prevalence of bad actors, and a system that promotes conflicting incentives. Factors

affecting the public as potential borrowers included a language barrier, instant credit mentality, lack of community resources, pressure for homeownership, a trusting nature, lack of education, lack of education opportunities and consumer awareness, and high foreclosure and default rates with corresponding negative effects on credit. Though participants were divided on whether Utah's legal system was too relaxed or too restrictive, the majority agreed that jurisdictional issues created a major problem in addressing unfair lending, and that enforcement and effectiveness of penalties could also be improved. Additional factors that influenced all areas include a lack or accountability on all sides of mortgage transactions, obstacles for redress for victims, scarce resources for effective education and prosecution, pressure to deliver a transaction and the lack of a common understanding of what unfair lending entails.

Practices

The common practices that are involved in unfair lending were divided between unfair actions, and unfair loan features. Unfair actions included 100% financing, the 3-year cycle of employment, bait and switch, cannibalism or minorities abusing minorities, criminal conduct, equity based lending, misleading information, scheme to steal, multiple salary qualification, flipping, abusive servicing, steering, unaffordable lending, preying on vulnerabilities, abusive networking, and over-appraising. Unfair loan features included adjustable rate mortgages, teaser rates, balloon payments, credit insurance, finances fees, hidden charges, high fees, high interest rates, interest only loans, and prepayment penalties.

Reduction

Methods or ideas for reducing unfair lending in Utah were contributed freely by participants, most of which referenced a change to one or more of the factors, practices or characteristics previously mentioned.

Legislation. Actor accountability should be increased through further licensing and continuing education. Steps the state has already taken to license and to require Principle Lending Managers, were positive moves. Penalties need to be more severe, in order to be an adequate deterrent. Tracking of the geographical pattern of areas with fast growth and high number of closings would be productive. Effectiveness and awareness of systems of legal redress for consumers needs vast improvement. Mandatory education for borrowers before entering a loan transaction was encouraged. Jurisdictional gaps between the Division of Real Estate, Department of Financial Institutions, and other regulatory bodies involved in home-based lending, need to be addressed. This issue needs to eventually be addressed at the federal level, because state laws have no jurisdiction over national financial entities.

Community Support. Community support is needed in greater abundance. Consumer support could possible come in the form of consumer advocacy groups, neighborhood revitalization programs, or funding.

Incentives. The industry needs to make more efforts to ensure customer satisfaction and long term relations through establishing an effective hotline for consumer feedback, accountability and industry imposed penalties on bad actors, and stronger lender-client relationships. Borrowers also need an incentive for getting themselves educated and aware of potential dangers in the mortgage lending market.

Financial education. Education is paramount, and cannot be overemphasized. Homebuyer education is an effective source for borrower education, but classes are not able to reach the hundreds of thousands of borrowers who need it. Funding for these classes and for advertising is needed, particularly from the industry itself because industry actors also stand to benefit from having mortgage ready borrowers. Timing of homebuyer education needs to be addressed, because once the consumer has already entered the buying process it is usually too late. Awareness needs to be increased, not only of homebuyer classes, but also of the value of the education as a protection from potential dangers they can encounter in the mortgage lending market. Consumers also need to be taught how to shop effectively for a good deal in the mortgage lending market, and need to learn how to properly rehabilitate and maintain good credit histories.

In spite of all the benefits of homebuyer education, it is merely a temporary solution to a much bigger problem, the lack of financial literacy among Utahns and Americans in general. Sound financial education is a long neglected, yet vitally needed subject, and is far more important than even algebra and other basic courses because everyone will use it. It is apparent that society in general is paying for their lack of financial preparation through epidemics of victimized consumers in every market, not just the home buying market. Utah has made steps to include a half of a credit of financial education in the high schools, but this is only a small step in the right direction. Elementary schools, junior high schools, colleges, and communities need to offer more classes, and consumers need to be made aware of their importance.

Concerning ideas for reduction of unfair lending one neutral participant summarized:

> Well, there's two ways you can come at this, this way, where people have a full array of opportunities and options for them, and are educated as to how to make correct choices. The other, which some states advocate and some consumer groups advocate is you just say, "No we are going to decide for you what loans you can make. We are going to take the judgment away from you and were going to limit lending to just this very narrow area, and prescribe all the terms and that's where credit will reside, and it won't be available any where else. And I think that's a lousy way to approach this. . . . I think this education should be in the secondary schools. It should be a mandatory high school course.

Consequences of Unfair Lending

The consequences of unfair lending can be numerous and far reaching. The industry, and investors bear some of the losses of unfair loans. Much of these costs are actually passed right back to the consumers in the form higher prices on loan products, though foreclosures and bankruptcies can have a ripple effect through the entire economy. Of course, the consequences to the individual borrower are often much worse and much more devastating. Victims often experience default, foreclosure and bankruptcy as a result of unfair loans.

CHAPTER V

DISCUSSION

This chapter will highlight the key findings of the data and discuss the similarities and differences of these findings and current literature on the subject. Implications of the key findings will then be discussed followed by the limitations of this study. Finally, suggestions for future research will be offered.

Key Findings

The intent of this section is not to directly compare every finding from the data to those in the literature, but rather to discuss the key findings of the data and how they contradict or support findings in current literature. Additionally, because data were specific to Utah and most current literature is nationally representative, differences in data and literature do not necessarily imply contradictions, but may simply represent differences in geographical location.

Definition

Participants explicitly defined predatory mortgage lending as targeted practices that intentionally exploit the vulnerabilities of borrowers. Implicitly, or in common use, participants used predatory mortgage lending to refer to a much wider range of practices including all instances of mortgage lending abuse and fraud. This inconsistency between definition and common use suggest that the term predatory lending is misunderstood, or rather lacks a common understanding. Its meaning is often associated with the perceptions of those who use it, and can sometimes carry negative connotations, attacking

implications, or stigma. The conclusion is that the term predatory lending serves as more of an obstacle to common understanding, than as a tool and should therefore be replaced with another, more encompassing, and less stigmatized term.

The term unfair lending was used throughout the remainder of the study to refer to all instances of predatory, abusive, fraudulent and harmful lending, though this term is not a definitive replacement. Unfair lending as defined by participants is one or more of the following: (a) a transaction without a fiduciary duty or having the borrower's best interest in mind, (b) a transaction the borrower does not completely understand for any reason including age, language barrier or lack of financial savvy, (c) any transaction that has no beneficial use or results in harm to the borrower, (d) any loan that delivers the lender excessive profits, and (e) any loan that the borrower does not have the ability to repay. This definition is not overtly measurable; therefore, the subsequent sections convey more detailed information offered by participants that is more easily measured.

None of the relevant literature to this point has suggested that the term predatory lending itself was an obstacle to achieving common understanding. This is indeed a new and unforeseen result that could ultimately prove to be very useful in the goal to reach common understanding. Additionally, only a few studies have attempted to define predatory/unfair lending, and when compared to the detail and clarity of the definition derived in this study, they certainly appear to be lacking (Engel & McCoy, 2002; U.S. Department of Housing, 2000).

Magnitude of Predatory Lending in Utah

Participants suggested that the magnitude or extent of unfair lending in Utah is directly indicated by the default, foreclosure, and bankruptcy rates in the state. Because Utah has ranked in the top ten in each of these categories over the last several years, this suggests that unfair lending in Utah is widespread and rampant (ABI, 2004; Federal Bureau of Investigation, 2005; Mitchell, 2003). However, when asked directly respondent comments were mixed, with some saying that unfair lending was prevalent and others saying that it was not.

Victim Characteristics

Borrowers are not the only victims of unfair lending. Investors, the industry itself, and sometimes even co-conspirators in fraud attempts can become victimized to a degree. In the literature, borrowers are nearly always seen as the sole victims in unfair lending (Calem et al., 2004; Engel & McCoy, 2002; Lord, 2005; Zimmerman et al., 2002). It is true, however, that the other victims do not suffer the same direct and staggering losses that borrowers often face, and therefore justifiably, the literature and most of the comments of participants were centered on borrowers as the victims.

Similar to reports in literature, borrowers are more vulnerable due to certain personal and financial attributes, such as being elderly, minority, low-income or bad credit (Newman & Wyly, 2002; Zimmerman et al., 2002). Unlike the literature, participants also explained that borrowers are generally unprepared mentally and emotionally to enter home loan transactions. They are often emotionally unsteady because of the magnitude of the transaction, and the thrill of instant gratification through

credit. Additionally, home loan transactions often coincide with major life changes such as a marriage, new job, and a change in friends and neighbors, and others that can emotionally impair a borrower's judgment. Along with fluctuating emotions, borrowers are frequently unprepared mentally to enter a home loan transaction. The complexities involved in a transaction, particularly in disclosures and other paper work, require all but the most dedicated and informed to place trust in the loan officer or broker, which unfortunately leaves them open to possibilities of abuse.

Factors That Foster Predatory Lending

Literature often focuses on the unethical and irresponsible market actors that are the perpetrators in cases of unfair lending (Engel &McCoy, 2002). While participants certainly agree, they also indicated that irresponsibility and lack of accountability persists on both sides of a transaction. Just as market actors are too willing to forsake their ethics to make quick profits, borrowers are too willing to trust their financial futures to some other party than themselves. Participants related that unethical market actors are currently difficult to hold accountable for unfair practices, and even those who are held liable face lenient penalties that do not act as sufficient deterrents of future actions by them or others. According to participants, borrowers themselves also frequently try to avoid accountability. Participants explained that most "unfair," "predatory," or "abusive" acts that occur to victims are actually fully disclosed in the paper work of the transaction and borrowers simply fail to read them, or fail to seek help if the material is over their heads, but instead leave the responsibility of ensuring fair transactions to the broker or lender.

The mortgage lending market is complex and vast, and nearly all parties involved in a mortgage transaction, at one point or another, face conflicting incentives (Kim-Sung & Hermanson, 2003, U.S. Department of Housing 2000). According to participants these conflicting incentives often result in a tradeoff of long term well being for more immediate, short term benefits. In other words, both borrowers and lenders have incentives to forsake the long-term stability of loans for more immediate benefits such as higher commissions, or large sums of instant credit. While participants lament that market structure, legal jurisdictions, and avenues of victim redress, are complex and full of contradicting incentives, they suggest that cooperation is still possible. While literature does address each of these issues to some extent, they are not emphasized as they were by participants (Engel & McCoy, 2002; Lord, 2005; Sturdevant & Brennan, 1999).

Practices

According to literature, unfair loans are the result of harmful acts or practices (Sturdevant & Brennan, 1999). What the literature does not fully explain is that loan features are not in and of themselves unfair, predatory, or abusive, but rather become unfair only when misused. The failure to make, or adequately emphasize this distinction has led many aggressive state legislatures to ban certain lending features (Lord, 2005; Quercia et al., 2003). Aggressive banning, or prohibitive legislation has had adverse consequences in some states, including a lack of competition among lenders and consequently, a lack of lending options for borrowers (Downey & Barr, 2006). Overly strict legislation would have the same effect that usury rate restrictions had in the early

1980's, which simultaneously hampered the lending business, and limited the options of borrowers, resulting in prime interest rates that were nearly quadruple the current 2006 rate. Participants have emphasized that instead of reverting to pre-1980's conditions, legislation should protect consumers while allowing legitimate business to flourish, and that there are legitimate uses for many loan features as long as they are used under the right circumstances. The specific actions and loan features that participants said they have seen in Utah, are not much different from those in the literature (Engel & McCoy, 2002; Sturdevant & Brennan).

Reduction of Predatory Mortgage Lending

The literature certainly suggested legislation as a solution to unfair mortgage lending, however, most suggestions alluded to prohibitive legislation, or the banning of specific loan features that are used to abuse borrowers (Engel & McCoy, 2002; Quercia et al., 2004). Participants of this study generally supported a more free market approach where market actors and borrowers are more accountable for their own actions, but still able to make their own decisions. The reasons for this feeling, discussed previously, were that it allows more options to the consumer, and allows legitimate business to prosper. The key to this approach is to reduce existing information asymmetries, or to insure perfect information and full accountability on both sides of the transaction. Licensing, increased penalties, more efficient victim redress, mandatory borrower education, and bridging jurisdictional boundaries were seen as methods of reduction that were focused more on accountability and responsibility.

Similar to research findings elsewhere, participants suggested increased cooperation between non-profit educators and financial institutions (U.S. Department on Housing, 2000). However, participants elaborated that the industry needs incentives to focus more on long term customer relations and well-being. The findings of the present study add to existing literature with suggestions of consumer advocacy groups and neighborhood revitalization committees as ways to increase borrower awareness and responsibility.

Much of the literature suggests some sort of education for borrowers, but these suggestions are nearly always secondary to suggestions for increased legislation (Engel & McCoy; Lord, 2005). Participants in this study emphasized that the primary method of reducing the occurrence of unfair lending is through education, and while certainly important, legislation is only secondary. This is consistent with the participants' views of a general free market attitude.

Homebuyer education courses are encouraged by participants as a short term remedy, as similarly echoed in the literature (Lord, 2005). However, the long term solution according to the participants is regular and frequent financial education courses in the secondary schools, colleges, and communities, something that is barely discussed in literature (Engel & McCoy, 2002).

Consequences of Predatory Lending

The industry and investors often bear some losses caused by unfair lending, but the large losses are incurred by individual borrowers. Their financial futures can be utterly destroyed by unfair lending practices. As victim tallies rise, the more and more

their losses are felt in the rest of the economy because high foreclosure and bankruptcy rates increase the cost of credit, and facilitate the use tax payer dollars that could otherwise be saved. The literature alludes to similar cost analyses, though not specifically for Utah (Stein, 2001).

Implications

A key implication of this study is that the term predatory lending should be replaced with a more encompassing, and less stigmatized term. At the very least, it should be understood by all parties involved that predatory lending can refer to all instances of unfair lending and not only those that are targeted, and that the perpetrator can be any mortgage actor not just a lender. This study used the term "unfair lending," and "actor" in the place of "predatory lending" and "lender" to emphasize the need for these changes. However, there is not conclusive evidence that these terms are the most suitable replacements because the topic of replacement terms was not addressed in this research.

Given the wealth of new data suggested by the participants in this study, there are numerous implications for multiple parties in the state. These are discussed next, though participants have related that any effective solution to unfair lending will be multifaceted, and require the cooperation and long term commitment of all parties discussed below.

Consumer Education

Borrowers. A key finding of this study is that consumers need to be fully responsible for ensuring beneficial transactions, because they cannot rely on the market

actors to do this for them. Undoubtedly the solution to unfair lending is multifaceted and requires legislation, and industry corrections, but hundreds of thousands of examples of unfair lending have proven that the market can be treacherous and that the borrower cannot trust his financial future to anyone but himself.

This is not to imply that each borrower needs to become an expert in the mortgage lending market, but it does mean that the borrower should be aware of unfair lending to the point that he knows of helpful resources, and places to go with specific questions on a loan. An additional possibility is the requirement of a third party attorney or mortgage lending professional, with incentives to act completely in the best interest of the borrower, to review mortgage documents, and ensure borrower understanding before signing. This would certainly add to the monetary cost of closing, but given the rampant amounts of abuse currently present in the market, this would likely reduce the real total costs of borrowing to consumers. Armed with full information and educated allies, borrowers have the potential to change the saying from "caveat emptor" (let the buyer beware) to "caveat venditor" (let the seller beware).

Consumer educators. Consumer educators need to continue doing what they do best: educate. The value of these services has been greatly underemphasized in the past and too often taken for granted. The participants of this study have placed a great deal of trust and responsibility in the hands of these educators. Additional sources of funding need to be sought out particularly from the lenders themselves who stand to gain from having mortgage-ready borrowers, and additional qualified educators are certainly needed throughout the state.

Consumer advocates. The duty of consumer advocates is to support the multifaceted solution. This entails extensive lobbying of the legislature for changes in the financial education opportunities in the schools and communities, and of funding for such programs. It also includes lobbying for changes in the code to increase penalties of perpetrators, for requiring mandatory education for borrowers, and for regulations that can bridge the jurisdictional gaps in the regulatory bodies of the state and nation. It also includes community support and community action groups, as well as good industry relations.

Policy Implications

Industry. The industry as a whole needs to understand that it also suffers from the hands of a few of its own actors. For its own good the industry should take a good hard look at the structure of incentives of its actors and do what it can to ensure that these actors will pursue the long-term stability of their loan products. Everyone wins when the transaction is fair and efficient. The industry should also voluntarily offer financial support to fund financial education courses for both children and adults.

Legislators and regulators. A key goal of further legislation is to increase accountability, and not to prohibit specific loan features. This can be done through efficient licensing, increased penalties, and mandatory borrower education.

It is essential that jurisdictional boundaries be bridged at the national level. As the current structure of mortgage regulation operates, states have very little power in assuring that all elements of the mortgage market are effectively monitored, such as second mortgages, or home improvement loans. For example, financial institutions that

are not based in Utah are not subject to the laws governing Utah. Instead they are held accountable by the state where the companies headquarters are located, which may be a much more lenient state, as far as mortgage regulations go. States, therefore, have misplaced incentives to allow more lenient legislation in order to draw the headquarters of larger businesses to the state, which ultimately increases state revenue through taxes. The residents of the state will likely suffer from unfair lending practices, but not significantly more than if the headquarters were located in another state, and the company continued to operate in the state by simply bypassing their laws. This is a very similar scenario to the exporting of interest rates of credit card companies located in South Dakota and Delaware. Some of the bigger, more widely dispersed financial institutions are able to entirely escape state jurisdiction all together, and are only monitored by federal regulators, who lack sufficient resources to effectively monitor mortgage lending across the entire nation.

Avenues for victim redress are also severely inadequate. A crucial role of the government is to provide support to its citizens act as an advocate on behalf of its citizens who are otherwise powerless. The implementation of an ombudsman office that works on behalf of consumers is a possibility. It is likely, however, that the issue of victim redress cannot be fully addressed until jurisdictional issues are sorted out.

An appropriate role for the government in a free market economy such as supported by the participants, is to ensure perfect information on both sides of a transaction. A crucial element in the efficiency of mortgage transactions is a financially educated consumer, however, current borrowers face extreme deficits of the necessary information needed to ensure fair transactions. It is, therefore, the government's

responsibility to ensure financial literacy of its citizens. This is something that state legislatures can immediately pursue, as opposed to waiting for jurisdictional issues to be working out.

The legislature needs to appropriate more funding and direct involvement in the administration of financial education. The duty of financial education can no longer be the sole responsibility of non-profit organizations but should be the duty of the state and federal governments due to the urgent and important nature of this need. Funding of such education programs should come at least partially from the lenders themselves, because they are primary beneficiaries of fair transactions.

School boards. Over the last 20 years, legislators have allowed the introduction of a more open economy by reducing usury rates and limitations on who can become lenders. The tremendous financial crises that are currently abound in the financial markets across the United States have come about because the legislature failed to simultaneously provide avenues for financial literacy education of American citizens. Without financial education consumers are effectively unarmed in a free market, and cannot function optimally because they lack information and understanding needed to make advantageous buying decisions. Participants have emphasized that financial education is essential for survival in today's credit based society, and is something that everyone will use almost every day of their lives. When put into perspective, financial education is indeed "more important than algebra."

Limitations of the Study

As in all qualitative studies, it cannot be assumed that the opinions of these twelve participants necessarily represent the opinions of the entire lending community of Utah because they do not constitute a representative sample of the population or the industry. However, the purpose of this study was to define and describe predatory lending through the eyes of a handful of everyday witnesses. In other words, this is an exploratory study to be built upon, and is not a conclusive study of mortgage lending practices.

Chain, or snowball sampling, was used in this study, which may have introduced certain biases of the researchers, who made the initial sampling decisions, and of participants who made the additional referrals. In addition, the assignment of participants to the categories of consumer advocate, industry advocate, and neutral participant was made mostly on the basis of how participants identified themselves. How well these perceptions would match those of others is unknown. However, the study's validity and reliability were strengthened using pilot interviews, continuing feedback from participants on research questions, member checks on interview content to ensure accurate meaning, and the use of assistant researchers to verify data coding and research design.

It is appropriate in qualitative works such as this to present a brief description of my potential biases as the primary researcher and facilitator in this research. It should be obvious that as a student of consumer sciences I have a natural tendency to side with the consumer, and I consider myself to be an active consumer advocate. In addition to this training as a consumer scientist, I also have a background in general economic theory. I

feel this unique combination of training has given me a somewhat objective view of this issue, and I can truthfully say that I have made every attempt to examine the issue of unfair (predatory) lending from all perspectives.

I understand as one participant put it, that "businesses have to make money, they are not philanthropic. They are in business to make money that's why they are called businesses." I also understand that one assumption in economic theory is that both the buyer and the seller (or borrower and lender in this case) have perfect or absolute information and are driven by invisible market forces to make the most fair, or efficient exchange possible. However, the requirement of perfect information is often absent in the real world and inefficient transactions occur every day, as seen in the cases with unfair, or as I like to say, inefficient lending.

Coming into this project I initially made the same assumptions as can be found in much of the literature on predatory lending: that the only way to rid the nation of these inefficient transactions was through tough and unyielding legislation. After many months of reviewing relevant literature, and even through the final stages of this research project, I continued to fully expect the results of this study to reach the same conclusion as the literature. During the data collection phase of this study I began to recognize that the responses of my participants did not entirely support this view, and that legislation was not the only answer, and not even the primary answer. Near the final stages of data collection, I slowly began to realize that my initial assumptions were not in line with the rest of my economic training that teaches that if market inefficiency is present it is either due to imperfect information or government involvement! At this point it became apparent to me that it was the former, though government intervention around the country

has been increasing over the last six to seven years, with mixed results (Downey & Barr, 2006).

This is not to say that I believe the government should play no role at all in the issue of unfair lending, but I do see the logic of the conclusions of this research; namely, that little good can come through prohibition of specific practices or loan features that are not in and of themselves predatory, because they are only predatory when they are *misused*. Doing so would be to simply revert to pre-1986 lending market conditions, where the flow of money was greatly impeded. A more useful role for the government, in my opinion, and as participants of this study suggested, is to license, track, and publicize the actions of the market, so that all borrowers and industry actors might be *aware* of the consequences of unfair lending.

From the mid 1980s to the present, the government has continually introduced more relaxed lending policies with the hope that American lending businesses can become more profitable. Theoretically there is nothing wrong with this sort of open economic policy. However in practice, consumers suddenly have new freedoms, but lack the skills required to make responsible decisions. The government should have also ensured full financial literacy of its citizens before it ever decided to relax lending standards. Though certainly past due, the government should now step up to its role of ensuring fair markets, and ensure that each American citizen has the opportunity to learn the skills necessary to make informed decisions in the marketplace. When information is held perfectly among all parties the only possible outcome is the most efficient, or most fair transaction, in which the price offered by suppliers meets the price demand by buyers.

The battle for perfect information or full education and awareness of all parties is certainly not an easy one, but at this point it is much too soon to doubt its potential because it has only scarcely been used as a preventative tool. Most current borrowers *do not* have financial education, most *have not* taken home buyer courses, and many of the borrowers currently entering the subprime market *are not* prepared mentally or financially for the long-term responsibilities of owning homes, and in my opinion should be dissuaded from pursuing homeownership until they are ready. I believe that an educated population of borrowers would seriously curtail mortgage lending abuses. In spite of the changing views I have had throughout this project I am confident that the data presented in chapter four speaks for itself, and that had the data collection and analysis been under the direction of another primary researcher that very similar conclusions would have been reached.

Suggestions for Future Research

The groundwork has been established for a thorough definition and description of predatory lending in Utah has been set through this research. There are many additional research endeavors that can proceed from this study, such as a quantitative study that measures some of the factors, practices, and characteristics described in this research to determine their degree of influence on unfair lending. It could also be very useful to conduct a similarly designed qualitative study to interview victims of predatory/unfair lending. Such a study would be useful for identifying their responsiveness to certain educational ideas, and awareness issues, and for verification of factors, practices and characteristics that led to their victimization. On a broader scale, the area of financial

education is crucial and also requires further research. Issues of timing of education, quality of education methods, and optimal quantities of education are all worthy research endeavors.

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APPENDICES

Appendix A. Informed Consent Form

Date Created: August 29, 2005
Utah State University IRB Approved 09/01/2005.
Approval terminates 08/31/2006.
Protocol Number: #1346
IRB Password Protected per True M. Rubal, IRB Administrator

Informed Consent
"Defining Predatory Mortgage Lending in Utah"

Professor Lucy Delgadillo and graduate student Luke Erickson in the Department of Family Consumer and Human Development at Utah State University are conducting a research study to help define Predatory Mortgage Lending in Utah. You have been asked to participate because you work in the real estate industry.

You will be asked to share experiences and opinions in a face-to-face interview that may last 20 minutes or no more than 2 hours, depending on your response to our questions. Your responses will be audio recorded and kept confidential unless you wish to be named in the final report of the research study. At that time, you will need to sign an approval statement. After data collection, all notes and recordings will be kept in a locked file cabinet in a locked office until completion of the research project. The recordings and notes will be destroyed approximately 10 months after the study is completed.

There are no direct benefits to participate in this study at this time; however, indirectly the home lending environment could be improved increasing the satisfaction of borrowers and lenders as well as third parties. There are no anticipated risks involved in participating in this research. If you have any questions you may contact either Luke Erickson at (435) 797-3408 or Professor Delgadillo at (435) 797-7204.

Your participation is voluntary and you may withdraw at any time without consequence. Any information obtained will be destroyed should you decide to withdraw. The Institutional Review Board (IRB) for the protection of participants in research at Utah State University has approved this study. If you have any questions or concerns about your rights you may call them at (435) 797-1821.

You have been given two copies of the informed consent. Please sign both copies, keep one copy for yourself and return the second copy to the researchers.

The research has been explained to the client by Luke Erickson or me and s/he understands the study, possible risks and benefits, and that taking part in the study is completely voluntary. The client has had a chance to ask questions and they have been answered.

____________________ __________ ____________________ __________

Professor Lucy Delgadillo Ph.D Date
Dept. of Family, Consumer & Human Dev.
Utah State University
2905 Old Main Hill, Logan, UT 84322-2905
Telephone: (435) 797-7204
Fax: (435) 797-3845
E-mail: lucyd@cc.usu.edu

Luke Erickson Date
Research Assistant
(435) 797-7204

By signing my signature I agree to participate: ____________________ __________

Participant's Signature Date

Appendix B. Interview Questions

Biographical Questions

1. What is your current title?
2. How long have you been in this position?
3. Could you briefly describe any previous positions related to mortgage lending?
4. How have your previous positions led to your current position?
5. What kind of contact do you have with others in the local and state mortgage markets?
6. How would you generally describe your experience in the mortgage market in Utah?

Main Research Questions

1. How would you describe or define abusive mortgage lending?
2. Would say that the term "predatory lending" captures what you have just described, or are there differences between them?
3. What do you feel is the magnitude or extent of high cost and abusive loans in Utah?
4. What are the major factors behind the existence of high cost and abusive home loans?
5. What are the specific abusive practices you have seen in home loans?
6. What are the common characteristics of borrowers who end up with predatory and/or abusive loans?
7. In your opinion, what could be done to reduce predatory mortgage lending in Utah?

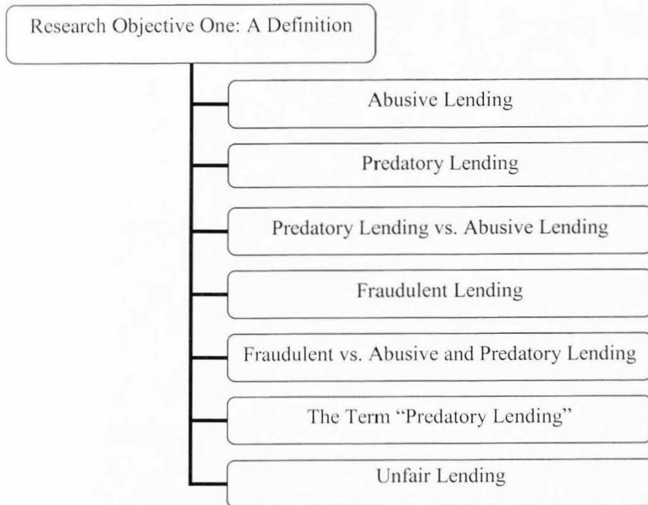
Other Questions

Who else in state would you recommend I interview to get more information on predatory mortgage lending?

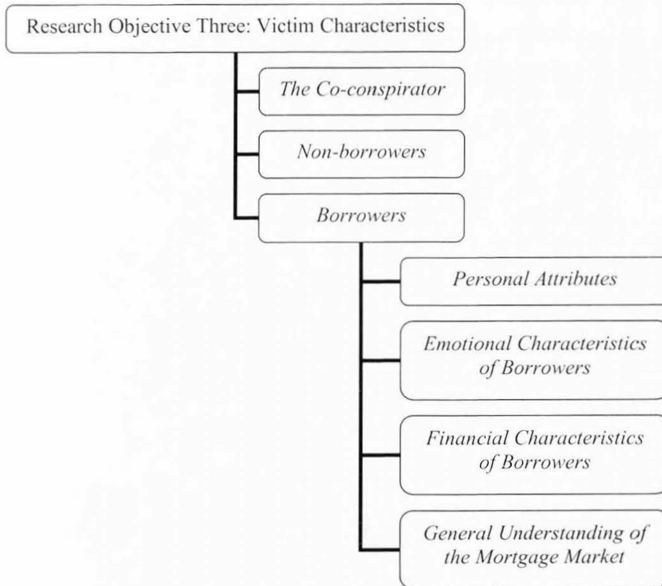
Do you have this person's contact information?

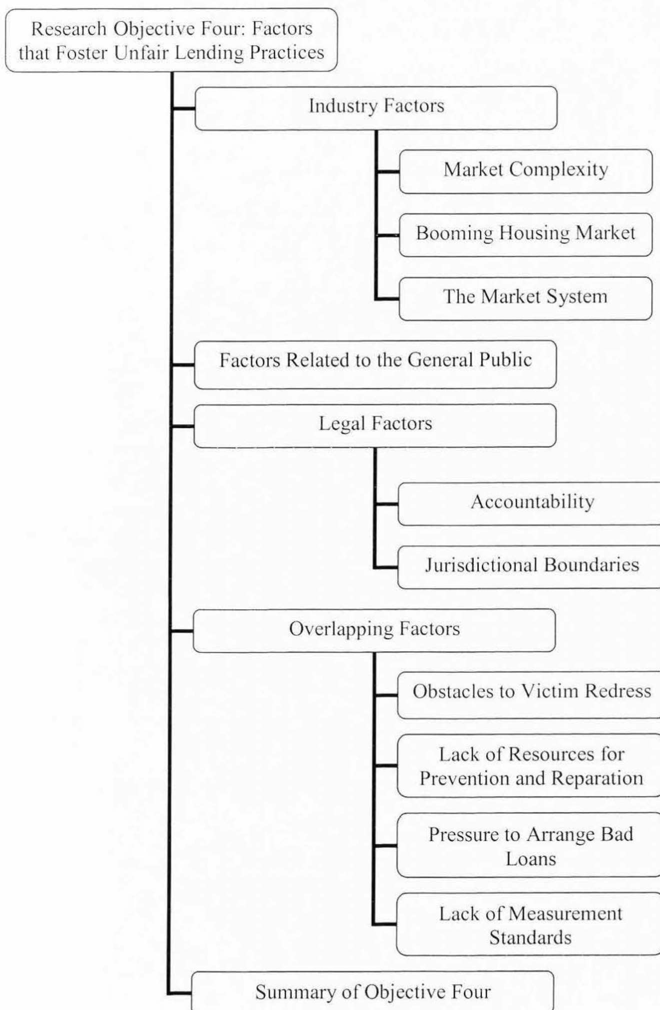
Do you think the questions I asked you would be sufficient for an interview with this person, or would you recommend changes?

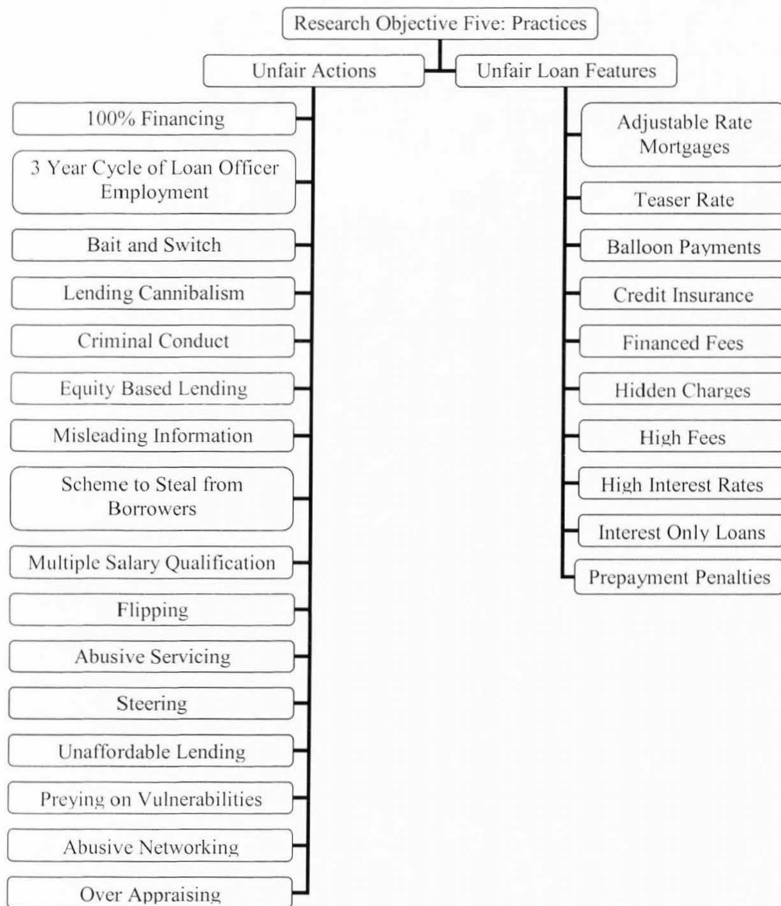
Appendix C. Coding Scheme of Results

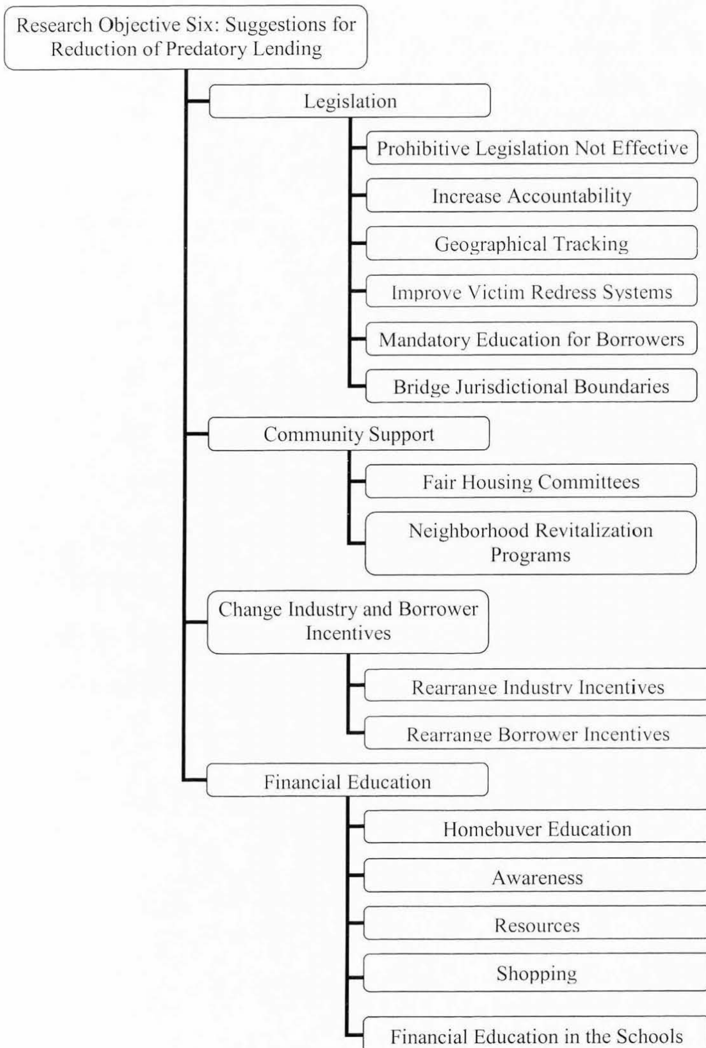


Research Objective Two: The Magnitude of Unfair


Research Objective Three: Victim Characteristics
The Co-conspirator
Non-borrowers
Borrowers
Personal Attributes
Emotional Characteristics of Borrowers
Financial Characteristics of Borrowers
General Understanding of the Mortgage Market


Research Objective Four: Factors that Foster Unfair Lending Practices
Industry Factors
Market Complexity
Booming Housing Market
The Market System
Factors Related to the General Public
Legal Factors
Accountability
Jurisdictional Boundaries
Overlapping Factors
Obstacles to Victim Redress
Lack of Resources for Prevention and Reparation
Pressure to Arrange Bad Loans
Lack of Measurement Standards
Summary of Objective Four


Research Objective Five: Practices
Unfair Actions
Unfair Loan Features
100% Financing
3 Year Cycle of Loan Officer Employment
Bait and Switch
Lending Cannibalism
Criminal Conduct
Equity Based Lending
Misleading Information
Scheme to Steal from Borrowers
Multiple Salary Qualification
Flipping
Abusive Servicing
Steering
Unaffordable Lending
Preying on Vulnerabilities
Abusive Networking
Over Appraising
Adjustable Rate Mortgages
Teaser Rate
Balloon Payments
Credit Insurance
Financed Fees
Hidden Charges
High Fees
High Interest Rates
Interest Only Loans
Prepayment Penalties


Research Objective Six: Suggestions for Reduction of Predatory Lending
Legislation
Prohibitive Legislation Not Effective
Increase Accountability
Geographical Tracking
Improve Victim Redress Systems
Mandatory Education for Borrowers
Bridge Jurisdictional Boundaries
Community Support
Fair Housing Committees
Neighborhood Revitalization Programs
Change Industry and Borrower Incentives
Rearrange Industry Incentives
Rearrange Borrower Incentives
Financial Education
Homebuyer Education
Awareness
Resources
Shopping
Financial Education in the Schools