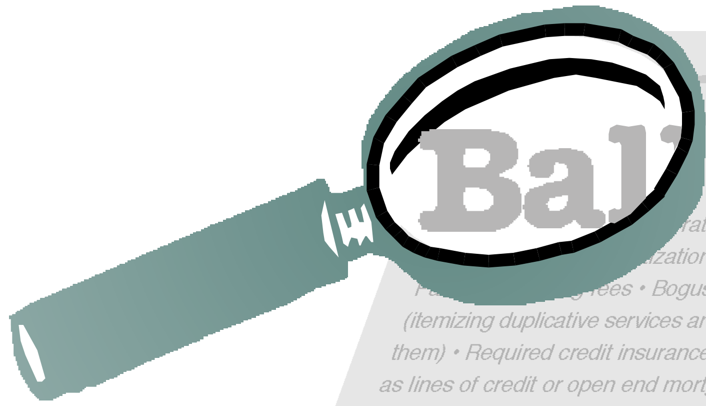


Exposing the Hidden Problem of Predatory Lending

by Peter Skillern and Jeanette Bradley

> “They did what a man with a gun in a dark alley couldn’t do. They stole my house.”
>
> — *Victim of predatory lender in Senate testimony, March 1998*

Building wealth through home ownership is a goal supported from the White House to local community development corporations. Great strides have been made in removing barriers and creating opportunities for home ownership. Unfortunately, this good work and the equity of thousands of homeowners are being stripped away through predatory lending practices. The wealth of low-income communities, in the form of home equity that homeowners have worked for years to build, is being siphoned off through unscrupulous lending practices that focus on moderate- to low-income and minority communities.

Predatory lending strips homeowner equity through illegal and unethical practices such as excessively high fees and commissions, the misrepresentation of the mortgage’s terms and conditions, high interest rates, repeated financing of loans, balloon payments and the financing of high-cost credit insurance. While anyone may be a victim of predatory lending,

Table 1: Market Share by Number of Loans			
Lender Type	HMDA Reporter Status		
	Non-Reporter	Reporter	Total
mortgage/finance	26.5% (2,270)	14.1% (1,210)	40.6% (3,480)
banks	0.6% (50)	53.4% (4,578)	54.0% (4,628)
builders	1.1% (97)		1.1% (97)
credit unions	0.4% (34)	3.8% (328)	4.2% (362)
total	28.6% (2,451)	71.4% (6,116)	100% (8,567)

(Raw numbers in parentheses)

our evidence suggests that these practices are more common in minority neighborhoods in and among minority and elderly households. For example:

The Alstons (not their real name), a minority family living in a moderate-income community in Durham County, North Carolina, were charged excessive fees on their mortgage when they refinanced to conduct some home improvements. These fees exceeded the consumer protection laws in North Carolina. In addition, the terms and conditions of the mortgage were not fully disclosed. The Alstons were not told that their mortgage was an adjustable rate until their interest rate jumped two percentage points at the end of the first year of payment. Learning they would pay thousands of dollars in prepayment penalties to refinance with another lender, the Alstons had few options but to refinance with the same lender for a fixed-rate mortgage. They were charged excessive fees again, which were included in the refinancing.

This process stripped away $10,000 in equity that the Alstons had built into their home. Though they felt wronged, they were unsure about their rights or what choices they had.

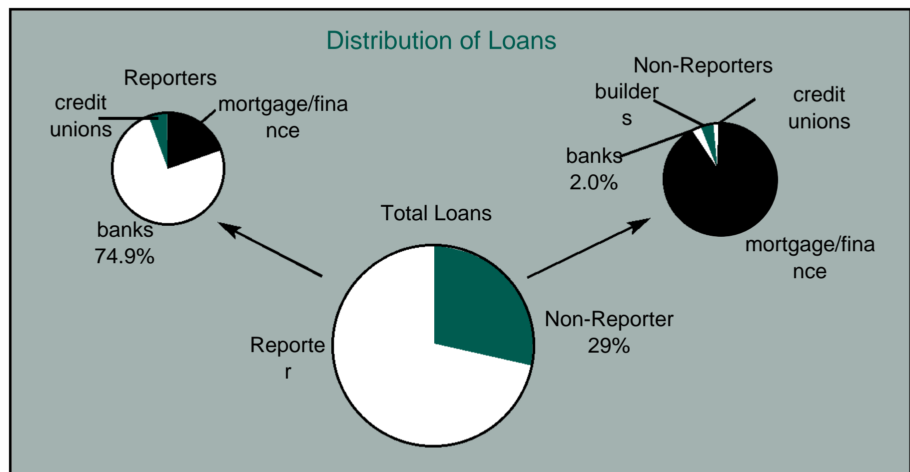
The predatory-lending example cited above was uncovered when the Community Reinvestment Association of North Carolina (CRA*NC) conducted a study of mortgage lending in 1996 in Durham County. CRA*NC is a nonprofit agency whose mission is to improve financial services to underserved communities. The goal of the study was to go beyond anecdotal evidence of predatory lending, by quantifying the prevalence of predatory and subprime lending in Durham County. CRA*NC also sought to develop a method for organizations in other states to do similar research.

To determine the number and type of loans that were being made in low-income and minority neighborhoods, CRA*NC entered all recorded deeds for Durham County in 1996 into a database from which lenders were identified by type. The addresses of all secured properties were mapped to determine their Census tracts. Using tax records, the researchers made contact with borrowers and encouraged them to share their loan documents and stories with the Durham Affordable Housing Coalition, a local nonprofit housing counseling agency.

Uncovering Unreported Lending

Much of what we know about the fairness of home mortgage lending in the United States comes from analyses of data collected under the Home Mortgage Disclosure Act (HMDA). Enacted in 1974, HMDA requires certain financial institutions to report their mortgage lending practices to federal regulators. They are required to report the race and income level of each borrower, and the Census tract in which the loan was made. Institutions are required to comply with the Home Mortgage Disclosure Act if they meet certain requirements of asset size, physical location of offices, and number of loans made annually. Banks are held to more stringent reporting standards than are non-depository institutions. Non-depository institutions are not required to report if they have an asset size of less than $10 million, or made fewer than 100 loans in a particular year.

These requirements are significant, because of all lending in Durham County in 1996, 28.6 percent, or 2,451 loans, were not reported in HMDA reports. In understanding credit markets in minority and low-income census tracts, an analysis of HMDA data alone significantly underreports the effective demand for credit, the type of loans being made and the institutions serving this market. For example, the study found that two out of every three loans made by mortgage and finance com-



panies in Durham County in 1996 were not reported in Home Mortgage Disclosure Act (HMDA) data.

Brokers Play A Large Role

Mortgage and finance companies made more than 92 percent of all the home mortgage loans not reported under HMDA (a total of 2,270 loans) in this study. In Durham County in 1996, 216 of the 374 mortgage and finance companies that made loans did not report them under HMDA. Because 78 percent of these companies made fewer than 20 loans and had no local office, we concluded that mortgage brokers and/or telemarketers play a large role in the type, quality and location of these loans. This high level of activity is significant because regulatory oversight of mortgage brokers and non-HMDA reporting lenders is significantly weaker than oversight of traditional bank lenders. In North Carolina, oversight of mortgage brokers is limited to a yearly registration. Without adequate regulation, consumer protection laws are more likely to go unexamined and uncorrected.

Disproportional Lending to Minority Census Tracts

Durham County, North Carolina, has a racial distribution of 37 percent African-American, 60 percent white and 3 percent other minorities. The Hispanic population is the fastest growing minority population. Residential segregation continues to be prevalent. In 1990, 28 percent of all African-Americans lived in Census tracts that were more than 90 percent African-American.

The following chart shows that as a percentage of their loan portfolios, mortgage and finance companies lent more of their portfolio to low income and minority

To estimate a minimum number of subprime loans in Durham County, researchers totaled the loans made by finance corporations and mortgage companies classified by HUD as subprime lenders. These 1,052 subprime loans represent 16 percent of the Durham market. If it is assumed that non-HMDA reporting mortgage companies are also subprime lenders, then the number increases to 3,320 — 34 percent of the market. Even if only a portion of these loans is predatory, many Durham homeowners are being stripped of their home equity

Census tracts than did banks. In fact, though they had a smaller total market share, mortgage and finance companies lent almost twice the percentage of their loans to minority Census tracts than banks did.

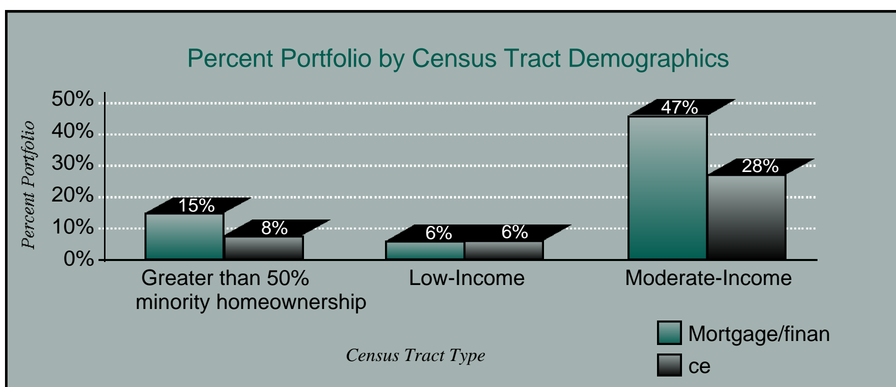
A statistical analysis found that as the percentage of minority homeowners in a Census tract increased, the number of loans by mortgage and finance companies increased. This was not due to the income level of the Census tracts. Black neighborhoods received more loans from mortgage and finance companies than white neighborhoods at the same income level.

The study found that two out of every three loans made by mortgage and finance companies in Durham County in 1996 were not reported in Home Mortgage Disclosure Act Data.

Bank Subsidiary Lending

Several mortgage and finance companies lending in North Carolina are owned by larger financial institutions that are covered by the Community Reinvestment Act. In completing a fair share analysis of individual HMDA-reporting banks and their subsidiaries, we found the same pattern that existed for banks and mortgage and finance companies as a whole. When compared to the parent company, the subsidiary made a greater percentage of its portfolio of loans to minority communities.

This pattern raises community reinvestment and fair housing concerns because these banks and their finance company subsidiaries appear to be segmenting the market and targeting minority communities for higher-priced, lower-quality credit products. If this is true, these companies may be in violation of the Fair Housing Act.



Defining Subprime and Predatory Lending

The rationale for charging one loan customer a higher cost (fees and interest) for a home loan than another customer is to compensate for the different levels of risk, based upon the borrowers' credit profiles. High-interest, high-fee loans are referred to as subprime mortgages. And the lenders who specialize in this niche market are called subprime lenders.

Subprime loans may or may not be predatory loans, depending on their terms and on how and why they are offered to particular borrowers. Mortgage and finance companies are more likely to make subprime loans. Nationally, subprime loan originations were estimated at $25 billion in 1994, growing to $160 billion in 1998.

Predatory lenders are a subset of subprime lenders. Proving predatory lending requires examining borrower loan documents and conducting interviews to determine if there has been a violation of consumer laws. Our survey of borrowers was limited to people who received loans from subsidiary companies of large banks. A limited review of loan documents indicated some subprime mortgage and finance companies in Durham County made predatory loans.

Of approximately 53 borrowers from two institutions, five borrowers responded.

From this small sample, we found evidence of several predatory lending practices. Lenders failed to disclose loan terms such as the existence of prepayment penalties and that rates were adjustable. Borrowers were routinely charged excessive fees; for example a 10-point origination fee was charged for a $24,000 first mortgage, in one case. In another, the loan terms at closing were different from those offered prior to closing. One client had the loan closed with a secretary representing the attorney. Clients received repeated phone calls and letters from their lenders and from other subprime lenders urging them to refinance their loans within a year of origination.

Conclusion

The study provides a number of indicators that the problem of predatory lending in minority and low-income communities is significant and worthy of further research and policy attention.

1) Two of every three loans made by finance and mortgage companies are not shown in HMDA reporting.
2) A significant proportion of loans made by finance and mortgage companies are subprime loans and are often made by unregulated brokers who stand to gain from high fees and repeated financing.
3) These subprime loans are made in a disproportionate number to minority and low-income neighborhoods, raising fair housing concerns of targeting higher cost credit to legally protected classes.
4) There are substantive cases of predatory lending that raise the possibility of systemic predatory lending practices by some subprime lenders including those owned by banks regulated by the Community Reinvestment Act.

There is a need for stronger consumer protection laws as well as enforcement of the existing laws in North Carolina to better protect consumers from high fees, flipping, equity stripping, and high-cost credit insurance. There is a need for better HMDA data to determine the type and quality of lending occurring.

Community groups and policy makers concerned with wealth building for lower-income households and neighborhoods should be concerned about predatory lending practices that seem designed to deplete wealth from our communities. Left unchecked, the equity that homeowners have built over a lifetime of hard work will continue to be taken with the stroke of a pen. ■

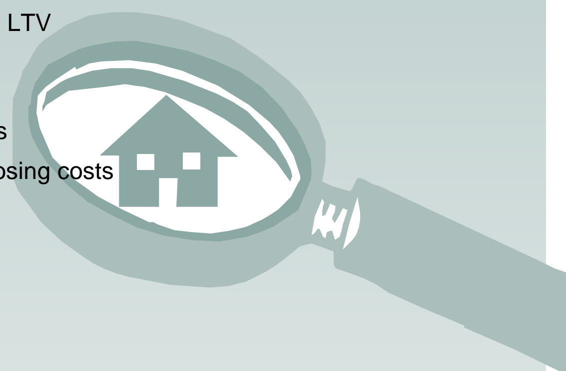
29 Indicators of a Predatory Lender

Marketing:

1. Aggressive solicitations to targeted neighborhoods
2. Home improvement scams
3. Kickbacks to mortgage brokers
4. Steering to high-rate lenders

Sales:

5. Purposely structuring loans with payments the borrower cannot afford
6. Falsifying loan applications (particularly regarding income level)
7. Adding insincere co-signers
8. Making loans to mentally incapacitated homeowners
9. Forging signatures on loan documents (i.e., required disclosures)
10. Paying off lower-income mortgages
11. Shifting unsecured debt into mortgages
12. Loans in excess of 100% LTV



The loan itself:

13. High annual interest rates
14. High points or padded closing costs
15. Balloon payments
16. Negative amortization
17. Inflated appraisal costs
18. Padded recording fees
19. Bogus broker fees
20. Unbundling (itemizing duplicative services and charging separately for them)
21. Required credit insurance
22. Falsely identifying loans as lines of credit or open-end mortgages
23. Force-placed homeowners insurance
24. Mandatory arbitration clauses

After closing:

25. Flipping (repeated refinancing, often after high-pressure sales)
26. Daily interest when loan payments are late
27. Abusive collection practices
28. Excessive prepayment penalties
29. Foreclosure abuses

Source: William J. Brennan Jr.'s statement to the U.S. Senate Special Committee on Aging, March 16, 1998.