

SHOPPING FOR A MORTGAGE? **DO YOUR HOMEWORK FIRST**

HOW TO AVOID PREDATORY LENDING

National Association of REALTORS®
The Voice for Real Estate®

Center for Responsible Lending

Beware of Predatory Loans!

For most families, buying a home is the biggest and smartest purchase they ever make. One of the keys to success is getting an affordable home loan with fair terms and reasonable costs. Unfortunately, home buyers need to be aware that some loans are not in their best interest. When loans hurt instead of help, they can quickly lead to foreclosure and even bankruptcy.

There is no single definition of predatory lending, because the term covers a wide range of abusive practices. Some practices may be predatory for one borrower but not for another, because everyone's circumstances are different. Predatory lenders often take advantage of first-time homebuyers and others who may be vulnerable to high-pressure sales tactics.

This brochure will help consumers learn about the risks of predatory loans and how to avoid them. REALTORS® can provide information about predatory lending, refer clients to reputable housing counseling organizations, and encourage families to make informed decisions about how to finance their homes.

Responsible lenders play a vital role in helping families achieve homeownership, but consumers need to make sure they are not dealing with a predatory lender. Some unscrupulous lenders are only interested in taking as much money as possible, and are not concerned about whether loans are affordable, sustainable, and truly helpful to home buyers and homeowners.

Remember the old saying: "If it sounds too good to be true, it probably is!"

Possible warning signs of a predatory loan

- Sounds too easy. "Guaranteed approval" or "no income verification" regardless of borrower's current employment, credit history, and assets. These claims indicate the lender doesn't care about whether you can afford to make the payments over the long haul.

- Excessive fees. Higher lender and/or mortgage broker fees than are typical in your market. Because these costs can be financed as part of the loan, they are easy to disguise or downplay. On competitive loans, fees are negotiable. It is common for home buyers to pay only one percent of the loan amount for prime loans. By contrast, a typical predatory loan may cost five percent or more.
- Large future costs. High-risk adjustable rate mortgages where the payment rises a lot after a short introductory period are seldom appropriate for families who already have had problems repaying other loans. Home buyers also should avoid a large single “balloon” payment (a lump sum due at the end of the loan’s term).
- Closing delays. The lender deliberately delays closing so the commitment on a reasonably-priced loan expires.
- Over-valued property. Inflated appraisals that allow excessive fees to be included in the loan and result in the borrower owing more to the bank than the home is worth.
- Barriers to refinancing. Prepayment penalties that make it hard for a borrower to refinance in order to pay off a high-cost loan by taking advantage of a low-cost loan.
- No down payment loans. These loans may be split into two mortgages, with one having a much higher cost. Home buyers should be sure they can afford the payments.
- Unethical document management. An ethical lender or broker will always require you to sign key loan papers, and they will never ask you to sign a document dated before the date you sign it.

What are some of the problems connected to predatory lending?

Nearly all predatory lending occurs in the “subprime market,” where loans are sold to people with less than ideal credit histories, such as a short work history, high debt, and a record of late payments on credit cards or other debt. Subprime loans have played an important role in helping millions of consumers achieve homeownership, but, unfortunately, some lenders abuse their role and take unfair advantage of vulnerable borrowers. Here are a few examples of problems with predatory loans:

High interest rates and fees. Predatory lenders often charge extremely high interest and fees that are added into the total amount of the loan the borrower must repay. These lenders charge what they can get away with, not a fair amount based on the credit history of the borrower.

Broken promises/“bait and switch.” Sometimes home buyers are offered a new loan or a refinance of an existing loan that seems to meet all of their needs only to find that interest rates and fees have changed when they get to the closing table. Agreeing to last-minute changes can cost thousands of dollars and result in a loan they just can’t afford.

Loans that start low and go high. Adjustable rate loans are popular in today’s market, but many that seem to be affordable are likely to have steep cost increases in the future. Avoid “payment shock” by considering whether you can pay for the loan both now and in the future.

Loan “flipping.” Too many homeowners are persuaded to refinance their mortgage, sometimes repeatedly, when there is no real benefit. Even when a family receives some cash from a refinance, the gains should be weighed against the costs of excessive fees and a higher loan amount. Often a borrower has other options, such as obtaining a second mortgage instead of refinancing the entire existing mortgage.

Steering. Some families who receive subprime loans could qualify for a much more affordable home loan. Predatory lenders use aggressive sales tactics to steer families into unnecessarily expensive loan products.

Shop for the lowest-cost loan

REALTORS® develop relationships of trust with the families they serve, and can help you avoid predatory loans by encouraging careful shopping. Ask these important questions:

- What is my credit score? Can I have a copy of my credit report?
- What is the best interest rate today? Do I qualify?
- Is the loan’s interest rate fixed or adjustable?
- What is the term (length) of the loan?
- What are the total loan fees?
- What is the total monthly payment? Does this include property taxes and insurance? If not, how much will I need each month for taxes and insurance?
- Is there an application fee? If so, what is it, and how much is refundable if I don’t qualify?
- Are there any prepayment penalties? If so, what are they and how long do they last?

If the loan is an adjustable rate mortgage (ARM), ask:

- What is the initial rate?
- How long will that rate stay in effect?
- How is the adjusted interest rate determined? (Generally, a specified amount—the “margin”—is added to a current published rate—the “index.”)
- How often can the rate change?
- How much can the rate go up each year and over the life of the loan? What is the maximum monthly payment you could be required to pay? Would you be able to afford it?
- Does the loan set a minimum interest rate?
- Do the monthly payments gradually decrease the amount you owe even if interest rates increase? (With some loans, the amount you still owe can increase rather than decrease each month—called “negative amortization.”)
- Does the interest rate increase if your payments are late?

- Could you qualify for a loan with the maximum interest rate permitted under the mortgage? If not, do you anticipate earning more in the future so you will be able to afford the higher payment?
- Can the adjustable rate mortgage loan be converted (changed) to a fixed rate without refinancing into a new loan? Is there a charge to convert?

Other solutions REALTORS® and home buyers can use to avoid predatory lenders

- Check out lenders with the Better Business Bureau, government websites, or other consumer groups. How long has the lender been in business? Have consumers filed many complaints? Does the lender belong to a trade association with ethics requirements for its members?
- Refuse to participate in transactions that may be fraudulent.
- Share predatory lending “horror” stories with regulators, other consumers, REALTORS®, counseling groups, housing professionals, and the media.
- Make contracts subject to the homebuyer receiving approval from a lender for a fair and affordable loan.
- Avoid unnecessary contract extensions that could cause the lender’s loan commitment to lapse.
- Get educated on the value of your home by asking your REALTOR® for a comparative market analysis.
- Review the HUD-1 closing statement **before** closing. Upon request, home buyers have the right to see this information 24 hours before the loan closing.
- Report possible violations to appropriate federal, state and local officials.

Additional Resources

The National Association of Realtors® (NAR):

For information on NAR’s Housing Opportunity Program, go to www.REALTOR.org/HousingOpportunity.

The Center for Responsible Lending (CRL):

For information about predatory mortgage lending practices, including “The Seven Signs of Predatory Lending,” go to www.ResponsibleLending.org.

Other brochures to help consumers shop for the best mortgage:

- NAR and CRL have issued two other brochures:
 - “Specialty (Non-Traditional) Mortgages: What Are the Risks and Advantages?”
 - “Traditional Mortgages: Understanding Your Options”
- NAR and the Federal Housing Administration of the U.S. Department of Housing and Urban Development have issued a brochure on “FHA Insured Mortgages.” FHA mortgages provide a safe and affordable option for homebuyers.

You may view, download, and order these brochures. Go to:

<http://www.realtor.org/housopp.nsf/pages/mortgages?OpenDocument>.

Fannie Mae: “For Home Buyers & Homeowners” at www.FannieMae.com.

Freddie Mac” “Buying and Owning a Home” at www.FreddieMac.com.

Ginnie Mae: For a simple calculator to help homebuyers estimate how much they can afford to spend, read “**How Much Home Can You Afford?**” <http://www.GinnieMae.gov>.

HUD Housing Counselors: For a list of counseling agencies, by state, approved by the Department of Housing and Urban Development (HUD), go to www.hud.gov/offices/hsg/sfh/hcc/hccprof14.cfm.

Credit-reporting agencies:

Equifax (800) 685-1111 www.Equifax.com

Experian (888) 397-3742 www.Experian.com

TransUnion (800) 916-8800 www.TransUnion.com

Go to www.AnnualCreditReport.com to ask for a free copy of your credit report, once a year, or call 877.322.8228.

See also www.FTC.gov.

“**Looking for the Best Mortgage**” is a brochure on how to shop, compare, and negotiate the best deal on a home loan. The brochure is a joint effort of 11 federal agencies, including the Federal Trade Commission (FTC), the Federal Reserve Board, HUD, and the Department of Justice. www.federalreserve.gov/pubs/mortgage/mortb_1.htm.

Consumer Handbook on Adjustable Rate Mortgages (the CHARM booklet) issued by the Federal Reserve Board (FRB) and the Office of Thrift Supervision (OTS).

<http://www.FederalReserve.gov>. At the FRB site, click on “publications and education resources” and then on “consumer information brochures.”

The National Association of Realtors®,

“The Voice for Real Estate,” is America’s largest trade association, representing more than 1.3 million members involved in all aspects of the residential and commercial real estate industries. For more information, please visit www.Realtor.org.

The Center for Responsible Lending is a nonprofit, nonpartisan research and policy organization dedicated to protecting homeownership and family wealth by working to eliminate abusive financial practices. CRL is affiliated with Self-Help, one of the nation’s

largest community development financial institutions. Please visit our website at www.ResponsibleLending.org.

This brochure was inspired by a brochure called “Help Your Clients Avoid Predatory Loans,” which was jointly issued by the Dayton Area Board of REALTORS® and the Miami Valley Fair Housing Center, Inc. The National Association of REALTORS® and the Center for Responsible Lending wish to thank them for authorizing us to use their brochure.

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