Tips for Avoiding a Predatory Mortgage Loan

What is Predatory Mortgage Lending?

A predatory mortgage is a needlessly expensive home loan that provides no financial benefit to the borrower in return for the extra costs. In many cases, homeowners are deceived about the loan's true costs and terms or are pressured into signing loans they cannot afford. Many of these homeowners lose their homes to foreclosure.

If you're in the market for a home loan, here are some questions you should ask and common predatory lending practices of which you should be aware. Because the information in this Guide is by no means complete, you should always have an attorney review all loan documents before you sign them. If you cannot afford an attorney, you should bring all of your loan documents to a HUD-certified housing counseling agency for review. To find a housing counseling agency in your area, see the list of agencies at the back of this Guide.

What is the mortgage loan amount?

The mortgage loan amount is the amount of money you are borrowing. When buying a home, this amount is usually the price of the home plus any fees and minus your down payment. If you are refinancing, the amount of your refinance loan should be the payoff of your current mortgage plus any fees. A refinance loan could also include any other debt you are paying off with your home loan or cash you receive at closing. You should be cautious when deciding whether to pay off other debt, such as credit card debt, with the proceeds of a mortgage loan. Doing so will increase your monthly payment and might mean foreclosure if you are not able to make that payment.

What is the full term of the mortgage loan?

Loan terms are generally 15, 20, 30, or 40 years. The longer the term, the more you will pay in interest over the full term of the loan. Some loans are structured so that you do not completely pay them off during the term of the loan. With this type of loan, you are obligated to pay off the remaining balance, or balloon payment, at the end of the loan term. Beware of mortgages containing balloon payments! If you do not have the funds or the ability to refinance the balloon payment, you could lose your property to foreclosure.

How much will my total monthly mortgage payment be? How is this payment divided between interest and principal for the term of the loan?

You need to know your total monthly payment amount to decide whether you can afford a particular loan. Just because a lender says you qualify for a certain loan amount does not mean that loan would be affordable. Some loan products offer "teaser rates"—low interest rates for a short period that later increase, resulting in significantly higher monthly

payments. Other loans allow borrowers to choose among several monthly payment options during the loan term, but some of these payment amounts may be too small to cover the interest or to pay down the amount owed on the loan. This means that, over time, you will actually owe more money to the lender than you owed at the start, even after making payments every month.

Do the monthly mortgage payments include property taxes and property insurance?

When the lender tells you the "monthly principal and interest" payment, it does not include the amount you need to pay every month for property taxes and insurance. All mortgage loans contain a requirement that the borrower pay property taxes and insurance. If the monthly payment that your lender quotes does not include a portion for property taxes and insurance, you need to add in those costs to determine your total monthly housing payment. Beware: Unscrupulous brokers or lenders will quote a low monthly payment and fail to include the cost of property taxes and insurance when describing what the monthly payment will be.

Is the interest rate on the loan "fixed" or "adjustable"?

The rate can be a "fixed rate," meaning that it remains the same throughout the entire term of the loan. There are also variable or adjustable rate mortgage (ARM) loans where the interest rate can change during the loan term. Often, an ARM offers a lower interest rate at the beginning of the loan term, which results in a lower monthly payment. However, the interest rate will almost always increase, and you will then have a higher monthly payment that you may not be able to afford.

What are the closing costs of the loan and to whom are they paid?

Closing costs may be difficult to spot because often they are paid from the loan that you are getting and not out of your pocket—but you are still paying them! Make sure you understand what each fee is and to whom the money is being paid. Ask for a "Good Faith Estimate" of your loan's closing costs—your lender is required by law to give you one within three days of taking your loan application. Ask if they'll guarantee it in writing and whether the extra fees are negotiable.

How much money is the mortgage broker being paid in connection with my loan?

Mortgage brokers are paid for helping a borrower obtain a loan from a lender. A reasonable compensation for this service is 2% of the loan amount (e.g., $2,000 on a $100,000 loan). The mortgage broker may also get a "yield spread premium" from the lender. This is a bonus the broker receives from the lender when the broker places you in a mortgage at a higher interest rate than you deserve. When this happens, the mortgage broker is being paid twice: the borrower pays a loan origination fee, and the lender pays a yield spread premium. You should be sure that your broker is not collecting excessive fees from your loan transaction.

Does the loan contain a prepayment penalty?

A prepayment penalty is a fee you will be charged if you pay off your loan early. Often, a lender charges a prepayment penalty in exchange for offering you a lower interest rate. If your loan has a prepayment penalty, you should ask your lender what the difference would be in the interest rate you would receive on the loan with and without a prepayment penalty. You want to make sure that you are receiving a benefit in exchange for the prepayment penalty.

Predatory Lending Red Flags

Excessive Fees

Look out for excessive and/or unnecessary fees. Loan fees should be no more than 3% (e.g., $3,000 on a loan of $100,000). Fees over 5% of the loan amount are excessive. Ask your broker or lender to show you an itemization of the loan amount with all fees explained.

Excessive Mortgage Broker Compensation (Yield Spread Premiums)

If you are dealing with a mortgage broker, find out how the broker will be paid. Sometimes brokers receive extra compensation from lenders called the "yield spread premium." This is extra pay the mortgage broker collects from the lender for signing the borrower to a loan with a higher interest rate than the borrower deserves.

Excessive Prepayment Penalties

Find out whether your mortgage includes a prepayment penalty. If it does, find out how much it is and how long it will be in place. You want to give yourself the option to refinance for better loan terms or pay your loan early without having to pay an excessive fee.

Equity Stripping

Look out if a lender bases the decision to give you a mortgage on the equity you have in your home instead of your income. A predatory lender may loan more than you can pay every month and wait for you to default on your loan. The predatory lender can then foreclose on your house and strip you of your equity!

Loan Flipping

Look out if you have been making your payments and a broker or lender encourages you to refinance for any reason. Each time the loan is refinanced, the lender charges fees that increase the amount you owe.

Misstated Income

Look out if the broker or lender changes any of the income information you provided. The lender may suggest that you could qualify for a higher loan amount by including income on your loan application that doesn't exist, or by inflating your income on the loan application. This practice is problematic because it qualifies you for a loan your income may not support.

Looking for a Home Loan?
Loan Product Worksheet

	Lender 1	Lender 2	Lender 3
Name of Lender			
Contact Person			
Date			
	Lender 1	Lender 2	Lender 3
Mortgage Loan Amount			
Length of Loan Term			
Fixed Rate or Adjustable Rate Mortgage			
Initial Interest Rate			
Date Interest Rate Changes			
How Often Can the Interest Rate Change?			
Maximum Interest Rate			
Initial Principal and Interest Payment			
Initial Monthly Payment Including Taxes and Insurance			
Is There a Balloon Payment?			
Amount of Balloon Payment and Due Date			
What Is the Most My Monthly Payment Could Be After 12 Months?			
After 24 Months?			
After 48 Months?			
After 60 Months?			
Is There a Prepayment Penalty?			
Amount of Prepayment Penalty			
Amount of Yield Spread Premium			
Total Broker/Lender Fee			

Notes:

Struggling to Make Your Mortgage Payments? Here's What to Do

The possibility of losing your home because you can't make the mortgage payments can be terrifying. Perhaps you are one of many consumers who took out a mortgage that had a fixed rate for the first two or three years and then changed to an adjustable rate. Maybe you're anticipating an adjustment, and want to know what your payments will be and whether you'll be able to make them. Or maybe you're having trouble making ends meet because of an unrelated financial crisis.

Regardless of the reason for your anxiety, you need to know how to save your home and how to recognize and avoid mortgage foreclosure scams.

Know Your Mortgage

Do you know what kind of mortgage you have? Do you know whether your payments are going to increase? If you can't tell by reading the mortgage documents you received at the loan closing, contact your loan servicer and ask. A loan servicer is responsible for collecting your monthly loan payments and crediting your account.

Here are some examples of types of mortgages:

> **Hybrid Adjustable Rate Mortgages (ARMs):** Mortgages that have fixed payments for a few years, and then turn into adjustable loans. Some are called 2/28 or 3/27 hybrid ARMs: the first number refers to the years the loan has a fixed rate and the second number refers to the years the loan has an adjustable rate. Others are 5/1 or 3/1 hybrid ARMs: the first number refers to the years the loan has a fixed rate, and the second number refers to how often the rate changes. In a 3/1 hybrid ARM, for example, the interest rate is fixed for three years, then adjusts every year thereafter.
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> **Adjustable Rate Mortgages (ARMs):** Mortgages that have adjustable rates from the start, which means your payments change over time.
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> **Fixed Rate Mortgages:** Mortgages that have a fixed rate for the life of the loan. With a fixed rate mortgage, the only change in your payment would result from changes in your taxes and insurance if you have an escrow account with your loan servicer.

If you have an ARM or a hybrid ARM and believe you will have trouble making increased payments, find out if you can refinance to a fixed rate loan. Review your contract first, checking for prepayment penalties. Many ARMs carry prepayment penalties that force borrowers to come up with thousands of dollars if they decide to refinance within the first few years of the loan. If you're planning to sell soon after your adjustment, refinancing may not be worth the cost. But if you're planning to stay in your home for a while, a fixed rate mortgage might be the way to go. Online calculators can help you determine your costs and payments.

If You Are Behind On Your Payments

If you are having trouble making your payments, contact your loan servicer to discuss your options as early as you can. The longer you wait to call, the fewer options you will have. After you've missed three or four payments and your loan is in default, most loan servicers won't accept a partial payment of what you owe. They will start foreclosure proceedings unless you can come up with the money to cover all the missed payments, plus any late fees.

Avoiding Default and Foreclosure

If you have fallen behind on your payments, consider discussing the following foreclosure prevention options with your loan servicer:

Reinstatement: You pay the loan servicer the entire past-due amount, plus any late fees or penalties, by an agreed-upon date. This option may be appropriate if your problem paying your mortgage is temporary.

Repayment plan: Your servicer gives you a fixed amount of time to repay the amount you are behind by adding a portion of what is past due to your regular payments. This option may be appropriate if you've missed only a small number of payments.

Forbearance: Your mortgage payments are reduced or suspended for a period to which you and your servicer agree. At the end of that time, you resume making your regular payments as well as a lump sum payment or additional partial payments for a number of months to bring the loan current. Forbearance may be an option if your income is reduced temporarily (e.g., if you are on disability leave from a job, and you expect to go back to your full-time position shortly). Forbearance isn't going to help you if you're in a home you can't afford.

Loan modification: You and your loan servicer agree to permanently change one or more of the terms of the mortgage contract to make your payments more manageable for you. Modifications can include lowering the interest rate, extending the term of the loan, or adding missed payments to the loan balance. A loan modification may be necessary if you are facing a long-term reduction in your income.

Before you ask for forbearance or a loan modification, be prepared to show that you are making a good-faith effort to pay your mortgage. For example, if you can show that you've reduced other expenses, your loan servicer may be more likely to negotiate with you.

Selling your home: Depending on the real estate market in your area, selling your home may provide the funds you need to pay off your current mortgage debt in full.

Bankruptcy: Personal bankruptcy generally is considered the debt management option of last resort because the results are long lasting and far reaching. A bankruptcy stays on your credit report for 10 years, and can make it difficult to obtain credit, buy another home, get life insurance, or sometimes, even get a job. Still, it is a legal procedure that can offer a fresh start for people who can't satisfy their debts.

If you and your loan servicer cannot agree on a repayment plan or other remedy, you may want to investigate filing Chapter 13 bankruptcy. If you have a regular income, Chapter 13 may allow you to keep property, like a mortgaged house or car, that you might otherwise lose. In Chapter 13, the court approves a repayment plan that allows you to use your future income toward payment of your debts during a three-to-five-year period, rather than surrender the property. After you have made all the payments under the plan, you will receive a discharge of certain debts.

To learn more about Chapter 13, visit the Web site of the U.S. Trustee Program, the organization within the U.S. Department of Justice that supervises bankruptcy cases, at www.usdoj.gov/ust.

If you have a mortgage through the Federal Housing Administration (FHA) or Veterans Administration (VA), you may have other foreclosure alternatives. Contact the FHA (www.fha.gov) or VA (www.homeloans.va.gov) to discuss your options.

Contacting Your Loan Servicer

Before you have any conversation with your loan servicer, prepare. Record your income and expenses, and calculate the equity in your home. To calculate the equity, estimate the market value minus the balance of your first and any second mortgage or home equity loan. Then, write down the answers to the following questions:

- What happened to make you miss your mortgage payment(s)? Do you have any documents to back up your explanation for falling behind? How have you tried to resolve the problem?
- Is your problem temporary, long term, or permanent? What changes in your situation do you see in the short term and in the long term? What other financial issues may be stopping you from getting back on track with your mortgage?
- What would you like to see happen? Do you want to keep the home? What type of payment arrangement would be feasible for you?

Throughout the foreclosure prevention process:

- Keep notes of all your communications with the servicer, including date and time of contact, the nature of the contact (i.e., face to face, phone, e-mail, fax, or postal mail), the name of the representative, and the outcome.

- Follow up any oral requests you make with a letter to the servicer. Send your letter by certified mail, "return receipt requested," so you can document what the servicer received. Keep copies of your letter and any enclosures.
- Meet all deadlines the servicer gives you.
- Stay in your home during the process, because you may not qualify for certain types of assistance if you move out. Renting your home will change it from a primary residence to an investment property and will, most likely, disqualify you for any additional "workout" assistance from the servicer. If you choose this route, be sure the rental income is enough to help you get and keep your loan current.

Consider Giving Up Your Home Without Foreclosure

Not every situation can be resolved through your loan servicer's foreclosure prevention programs. If you're not able to keep your home, or if you don't want to keep it, consider:

Selling Your House: Your servicer might postpone foreclosure proceedings if you have a pending sales contract or if you put your home on the market. This approach works if proceeds from the sale can pay off the entire loan balance plus the expenses connected to selling the home (e.g., real estate agent fees). Such a sale also would allow you to avoid late and legal fees and damage to your credit rating, and protect your equity in the property.

Short Sale: Your servicers may allow you to sell the home yourself before it forecloses on the property, agreeing to forgive any shortfall between the sale price and the mortgage balance. This approach avoids a damaging foreclosure entry on your credit report. You still may face a tax liability on the amount of debt forgiven. Consider consulting a financial advisor, accountant, or attorney for more information.

Deed in Lieu of Foreclosure: You voluntarily transfer your property title to the servicer (with the servicer's agreement) in exchange for cancellation of the remainder of your debt. Though you lose the home, a deed in lieu of foreclosure can be less damaging to your credit than a foreclosure. However, you will lose any equity in the property, and you may face an income tax liability on the amount of debt forgiven. This may not be an option for you if other loans or obligations are secured by the property on your home.

Housing and Credit Counseling

You don't have to go through the foreclosure prevention process alone. A counselor with a HUD-certified non-profit housing counseling agency can assess your situation, answer your questions, go over your options, prioritize your debts, and help you prepare for discussions with your loan servicer. Consult the list of housing counseling agencies at the back of this Guide to find an agency in your area.

Facing Foreclosure? Beware the "Rescue" Scam!

If you are a homeowner at risk of losing your home due to foreclosure or unpaid property taxes, you may be a target for businesses seeking to profit from your misfortune. Many of these business may try to exploit your emotional vulnerability in order to con you out of the few assets you have left.

Two such businesses carry a high potential for fraud and abuse: mortgage rescue consultants and mortgage rescuers. The following information explains how these schemes work and why they are risky. You also will find an explanation of your rights under the Mortgage Rescue Fraud Act, a law that Attorney General Madigan sponsored to protect our homes and neighborhoods from the scourge of mortgage rescue fraud.

How the Rescue Schemes Work

Mortgage Rescue Consultants

For a hefty fee, mortgage rescue consultants promise to "buy you time" and possibly save your home by negotiating deals with your creditors. They may also offer to help you repair your credit and refinance your existing mortgage.

These services may sound like something you really need, but the truth is they all can be performed *better* by a licensed attorney, a reputable non-profit housing counselor, or you.

All too often, mortgage rescue consultants offer homeowners phantom help. They either do nothing they promised to do, or they do the bare minimum, perhaps placing a phone call to the homeowner's bank or mailing the homeowner a list of refinancing sources they found on the Internet. Meanwhile, the homeowner wastes valuable time that could be spent really trying to save the home.

Mortgage Rescuers

If you are on the verge of losing your home but have built up equity in the property, you are a prime target for so-called "mortgage rescuers." Typically, mortgage rescuers will promise to "save your home" by offering you a three-part deal:

- The rescuer (or a third party investor) buys your home from you for a small fraction of its actual value.
- You stay in the home as a renter.
- You get to buy back the home when you're back on your feet financially.

As tempting as this deal may seem, it is a recipe for a rip-off. "Rescued" homeowners often find themselves struggling to make monthly rent payments that are comparable to or even higher than their former mortgage payments. When the homeowners fall behind in rent, the new owners ask a court to evict them. In the worst cases, the homeowners do not even realize they have sold their home until they receive the eviction papers. Even homeowners who keep up with their rent payments are often unable to buy back the home when their lease expires.

Whether they're evicted or move out voluntarily, homeowners lose both their home and their equity in these schemes. The only people who win are the rescuers and their investors, who end up reaping huge profits on homes for which they paid very little.

Consumer Protections Under the Mortgage Rescue Fraud Act

A "rescue" should not leave homeowners worse off than they would have been without it. The Mortgage Rescue Fraud Act, which went into effect on January 1, 2007, protects homeowners' hard-earned equity with the following key provisions:

Mortgage Rescue Consultants

- Mortgage rescue consultants must give homeowners a written contract listing all the services that the consultant promises to perform.
- Homeowners have the right to cancel a consultant contract at any time.
- A consultant cannot accept any payment from the homeowner until all of the services have been performed.

Mortgage Rescuers

- A mortgage rescuer must provide the homeowner with a written contract that clearly states that the home is being sold.
- Prior to sale, the rescuer must make a determination that the homeowner has the reasonableability to make rental payments and buy the home back.
- A homeowner who remains in the home under a rental agreement has the right to cancel the rental agreement at any time.
- A mortgage rescuer must pay the homeowner at least 82 percent of the home's fair market value if the rescue ultimately fails.

Explore Your Options

Out of fear or shame, homeowners at risk of losing their homes often postpone seeking help. This makes them vulnerable to mortgage rescue scam artists, who typically portray themselves as the only option the homeowner has left. As a general rule, **beware of anyone who calls you or shows up at your door promising to save your home.** Real help doesn't find you; you have to go looking for it.

If you're facing foreclosure, a counselor with a HUD-certified housing counseling agency can assess your situation, answer your questions, go over your options, prioritize your debts, and help you prepare for discussions with your loan servicer. To find an agency in your area, consult the list of housing counseling agencies at the back of this Guide.

If you believe you have been victimized by a mortgage rescue scam, you should contact our Consumer Fraud Hotline immediately at the phone numbers listed on the back cover of this Guide.