Consumer Concerns for Older Americans

Helping Elderly Homeowners Victimized by Predatory Mortgage Loans

Equity-rich, cash poor elderly homeowners are an attractive target for unscrupulous mortgage lenders. Many elderly homeowners are on fixed or limited incomes, yet need access to credit to pay for home repairs, medical care, property or municipal taxes, and other expenses. The equity they have amassed in their home may be their primary or only financial asset. Predatory lenders seek to capitalize on elders' need for cash by offering "easy" credit and loans packed with high interest rates, excessive fees and costs, credit insurance, balloon payments and other outrageous terms.

Deceptive lending practices, including those attributable to home improvement scams, are among the most frequent problems experienced by financially distressed elderly Americans seeking legal assistance. This is particularly true of minority homeowners who lack access to traditional banking services and rely disproportionately on finance companies and other less regulated lenders. But there are steps advocates can take to assist victims of predatory mortgage loans.

A Few Examples . . .

> One 70 year old woman obtained a 15-year mortgage in the amount of $54,000 at a rate of 12.85%. Paying $596 a month, she will still be left with a final balloon payment of nearly $48,000 in 2011, when she will be 83 years old.
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> Another 68 year old woman took out a mortgage on her home in the amount of $20,334 in the early 1990s. Her loan was refinanced six times in as many years, bringing the final loan amount to nearly $55,000. She paid for credit life insurance all six times, with each premium exceeding $2,300.
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> The mortgage loan of a 72 year old man was refinanced three times in four years, twice by the same company. Over the course of the three refinancings, the loan amount doubled, from about $16,500 to $33,000. The final loan had an interest rate of 16.85%. Living on Social Security and unable to afford the monthly payments, Phillips sought bankruptcy in an attempt to save his home.

Why Predatory Lending and Foreclosures are on the Increase

Several factors have lead to the increase in predatory mortgage lending. Among them is the deregulation of the consumer credit industry in the 1980s which lead to the weakening of state regulatory and consumer protection statutes. A change of the tax code in 1986, which established a preference for second mortgage interest over interest on other consumer loans, led to aggressive marketing by lenders of the tax benefits of home equity loans. Consequently, many formerly unsecured obligations, such as medical bills and credit card debt, are now folded into higher-rate loans secured by homes even if the low-income consumer gets little or no tax benefit.

Another important factor is the increase in real estate property values in the 1990s. Some predatory lenders profit by making loans based solely on the value of the collateral, the equity in the home, rather than the homeowner's ability to repay the loan. This practice is profitable because if the homeowner cannot repay this high-rate, high-fee loan, the lender forecloses, purchases the home at auction, and resells it at a profit. This problem disproportionately affects the elderly, since they frequently have substantial equity built up over a long period of time and have little income to repay these loans.

Elderly homeowners who have sought legal assistance frequently say that they were unaware of the terms of the loan agreement they were signing. Often the terms of the loan are not fully explained to the elder. At other times, home improvement companies, who often act as brokers for many of these predatory mortgage loans, will use high pressure tactics or engage in other behavior to intentionally misrepresent or obscure the terms of the loan or its true cost. When elders get loans they cannot afford, they quickly fall behind and ultimately face foreclosure.

How to Identify Predatory Mortgage Loans

There are several "warning signs" that a loan may be abusive or predatory. Not all loans containing one or more of the following attributes are predatory loans. However, the features listed below are often associated with such loans.

- **Misrepresentation or fraud in the solicitation, marketing or origination of the loan.** For example, a lender may falsify a loan application to make it appear that an elderly applicant has enough income to qualify for a loan. A lender who desires to profit from a homeowner's equity by making a loan the elderly homeowner cannot afford to pay, and which will ultimately lead to foreclosure, may engage in this behavior.
- **Home improvement scams.** Home improvement contractors often steer elderly homeowners to predatory mortgage companies under the guise of arranging financing to pay for the home improvement. The work is generally overpriced, and often incomplete or done in an extremely shoddy manner. The contractor may obtain a commission for acting as a broker on the loan.
- **High interest rate.** In many cases, the high interest rate cannot be justified by the risk and costs of providing credit to elderly homeowners. Predatory lenders often disguise the true costs of loans by using adjustable rate mortgages having an artificially low interest rate and monthly payment, called a "teaser" rate, for a limited period of generally six months to two years. For elderly homeowners on fixed incomes, an increase in the monthly payment after the initial period can be devastating.
- **High closing costs and fees.** Closing costs include points, broker's fees, document preparation fees, appraisal fees and attorney fees which are deducted from the proceeds of the loan. These fees may be much greater than the actual cost of the item or service provided, or duplicative of other itemized fees and costs.
- **Balloon payments.** A balloon payment is a large lump sum of money due at the end of the term of the loan. Homeowners who cannot meet the balloon payment will lose their home to foreclosure unless they refinance the loan, often at an excessive cost.
- **Excessive prepayment penalty.** Lenders often impose excessive and unfair prepayment penalties to make even more profit if the homeowner attempts to refinance.
- **Multiple refinancing.** This practice is also referred to as "flipping." Lenders encourage homeowners (especially those with balloon payments described above) who are in need of credit, or who are in default, to refinance their loan with the lender or an undisclosed affiliate of the lender. The new loan pays off the balance of the existing loan, including any prepayment penalty embedded in that loan. The resulting loan has a higher principal balance and a new set of closing costs and fees based on that higher balance. A loan may be refinanced several times in this manner. Each time the loan is refinanced the lender receives a new set of closing costs and fees, which leads to depletion in equity with littler

or no benefit to the elderly homeowner.

- **Credit insurance.** Lenders will sell credit life insurance, credit accident and health insurance, or involuntary unemployment insurance, as part of the loan. This insurance is extremely profitable for the lender, as the lender often owns the insurance company, or receives a commission for the sale of the insurance. In addition, the insurance premium is often financed over the life of the loan which increases the total interest charged on the principal. Because it is profitable, credit insurance is often sold to individuals who will not benefit from it. Fortunately, due to changes in federal regulations, this practice has become much less common than it was.

- **Negative amortization.** The lender structures the loan such that the monthly payments do not cover the amount of interest due each month on the loan, and the principal balance therefore increases each month. At the end of the loan term in a negative or non-amortizing loan, the borrower owes more than the amount originally borrowed.

- **Mortgage broker kickbacks.** Borrowers pay a fee to a broker to obtain the best available rate on a loan. This fee is usually financed as part of the loan. The broker, however, may also receive a separate fee or commission from the lender for referring the homeowner to the lender. Instead of receiving the best rate that he or she qualifies for, the borrower may pay a higher interest rate because the broker is receiving a kickback from the selected lender. The fee the lender pays to the broker is passed on to the homeowner in the form of a higher interest payment over the loan term. On loan documents this is referred to as a yield spread premium.

- **Making loans the elderly homeowner cannot afford to repay.** These loans are made based solely on the amount of equity in a property, and are made to individuals who do not have the income to repay the loan. Elderly homeowners are particularly vulnerable to this practice because they have limited or fixed incomes and have substantial equity in their homes.

- **Refinancing unsecured debt.** Lenders encourage homeowners to finance or consolidate unsecured debt, such as credit cards or medical costs, into the mortgage loan. Homeowners are told it is a way to lower monthly payments and increase their tax deduction. Lenders do not mention that the higher home-secured debt burden increases the risk of foreclosure when the elder faces financial distress.

Legal Challenges to Predatory Mortgage Loans

Elderly homeowners who have been victimized by predatory mortgage lenders have a number of legal options. What follows is a brief summary of some legal options advocates can use to challenge abusive mortgage lending. These claims are complex; please consult the additional resources listed at the end of this Consumer Concern.

The Truth in Lending Act (TILA)

Under the Truth in Lending Act [1] a homeowner has a right to rescind a non-purchase money loan secured by his or her primary residence. This includes home equity loans and home improvement loans, whether first or second mortgages, so long as the proceeds of the loan were not used to purchase the home. The homeowner must be provided with a notice of this right to cancel. The homeowner has a right to rescind the loan for up to three business days after the transaction and an extended right to rescind the loan for up to three years if he or she was not given a notice of this right to cancel the loan, or if he or she did not receive notice with all of the required material disclosures. TILA also requires lenders to disclose the terms of loans in an understandable manner. The National Consumer Law Center’s Truth in Lending manual provides detailed information on how TILA can be used to challenge predatory loans.

Home Ownership and Equity Protection Act (HOEPA)

The Home Ownership and Equity Protection Act (HOEPA), an amendment to TILA, covers certain high rate, non-purchase money, home loans.[2] In addition to notice of the right to cancel and other disclosures required by TILA, if a loan is covered under HOEPA, lenders must provide borrowers with additional disclosures of the, principal amount of the loan, the APR and the monthly payment three days prior to closing. If there is a balloon payment at the end of the mortgage the amount of the balloon payment must be disclosed. Also if the mortgage is a variable rate mortgage, the highest possible monthly mortgage payment must be disclosed. These disclosures must also include provisions telling the borrower that they are not required to sign the loan agreement simply because they received the disclosure statements, and they may lose their home if they do not meet their obligations under the terms of the loan.

In addition to the disclosure requirements, HOEPA prohibits the inclusion of certain terms in the loan contract. A loan covered under HOEPA may not include the following: a term which increases the interest rate in the event of default; balloon payments in loans of less than five years; negative amortization; more than two prepaid payments; extending credit to individuals without regard to their ability to repay the loan; most due-on demand clauses; and disbursement of funds payable solely to a home improvement contractor instead of jointly or solely to the consumer. Most prepayment penalties are also prohibited.

Violations of HOEPA's disclosure provisions and inclusion of prohibited contract terms will give rise to civil liability for actual damages, statutory damages, and attorney fees and costs. In addition, there are special enhanced damages, of finance charges and fees paid by the consumer, for material violations. Most HOEPA violations also give rise to the TILA's extended right to rescind. Assignees of loans covered under HOEPA are liable for all claims and defenses with respect to the assigned mortgage that the consumer could assert against the originator of the loan, except to the extent of certain limitations on damages.

By 2006 most lenders claimed to be no longer making loans that had such a high interest rate or such high points and fees that they qualified as HOEPA loans. However, a loan that on the surface appears to be below the HOEPA triggers may actually be a HOEPA loan once the lender's characterization of various loan charges is scrutinized.

Real Estate Settlement and Procedures Act (RESPA)

Among other provisions, the Real Estate Settlement and Procedures Act (RESPA)[3]prohibits the payments of unearned fees and kickbacks. A lender kickback to a mortgage broker for making a referral is forbidden. The remedy for violation of this provision is treble damages and attorney fees.

State Unfair and Deceptive Acts and Practices Laws

Many of the abusive practices and loan terms found in predatory mortgage loans can be challenged under state unfair and deceptive acts and practices (UDAP) laws.[4] If a state's UDAP statute covers the type of transaction or the creditor involved, advocates may bring claims for practices such as repeated and unnecessary refinancing ("flipping") of loans, making unaffordable loans to consumers to acquire the equity in the property, or misrepresenting the loan terms. Excessive fees and costs, and other terms that are disadvantageous to the borrower may be challenged as well.

Other Laws

Warranty law, usury, unconscionability, breach of fiduciary duty, fraud, and contract law have remedies which may prove helpful in challenging abusive loans. Some states have laws that regulate predatory home loans.5 Other laws, including the Equal Credit Opportunity Act and the Fair Housing Act, have also been used to challenge these practices.

For More Information

Several manuals published by the National Consumer Law Center will be helpful for advocates challenging these practices.

- Stop Predatory Lending: A Guide for Legal Advocates (January 2002)
- Truth in Lending (5th ed. 2003 and Supp.).
- The Cost of Credit (3rd ed. 2005)
- Repossessions (6th ed. 2005)
- Foreclosures (1st ed. 2005)
- Unfair and Deceptive Acts and Practices (6th ed. 2004 and Supp.)
- Consumer Bankruptcy Law and Practice (7th ed. 2004 and Special Guide to the 2005 Act)

In addition, several other organizations involved in predatory lending issues have additional information on the subject.

American Association of Retired Persons (AARP), Consumer Affairs Division, 601 E. Street, N.W., Washington, D.C. 20410, (202) 434-6044 or http://www.aarp.org

Federal Trade Commission, Office of Consumer/Business Education, 7373 147th St. N.W. Washington, D.C. 20580. The FTC has several publications on home equity fraud on its website at www.ftc.gov/bcp/menu-lending.htm or call 1-877-FTC-HELP.

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1 15 U.S.C. §§ 1601 et seq. For more information, see generally National Consumer Law Center, Truth in Lending (5th ed. 2003 and Supp.).

2 15 U.S.C. § 1639. The effective date of HOEPA was October 1, 1995. For a discussion of HOEPA, see National Consumer Law Center, Truth in Lending, Ch. 9 (5th ed. 2003 and Supp.).

3 12 U.S.C. §§ 2601 et seq. See generally National Consumer Law Center, The Cost of Credit: Regulation and Legal Challenges, § 11.3 (1995).

4 See generally National Consumer Law Center, Unfair and Deceptive Acts and Practices (6th ed. 2004 and Supp.).

5 See generally National Consumer Law Center, Cost of Credit Ch. 12(3rd ed. 2005).