

How to Avoid Predatory Lending

For most families, buying a home is the biggest and smartest purchase they ever make. Unfortunately, not all loans are in their best interest.

When loans hurt instead of help, they can quickly lead to foreclosure and even bankruptcy. It's important to learn the warning signs and common problems associated with predatory lending, and to ask the right questions when shopping for low cost loans.

The term, "predatory lending" covers a wide range of abusive practices. Some 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, so it pays to know how to protect yourself and who can help.

Possible warning signs of a predatory loan

- * It sounds too easy: "Guaranteed approval" or "no income verification" sometimes indicate that the lender doesn't care whether you can afford to make the payments over the long haul.

- * Excessive fees: Make sure fees are typical of those 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 with payments that rise substantially after a short introductory period are seldom appropriate for families who already have had problems repaying other loans. Home buyers should also avoid a large, single "balloon" payment (a lump sum due at the end of the loan's term).

- * Closing delays: A lender who deliberately delays the closing may be waiting for the commitment on a reasonably-priced loan to expire.

- * Over-valued property: Inflated appraisals can allow for excessive fees to be included in the loan, resulting in the borrower owing more to the bank than the home is worth.

- * Barriers to refinancing: Prepayment penalties can make it hard for borrowers to refinance and take advantage of a lower-cost loans.

- * 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.

Some common problems associated with predatory lending

Nearly all predatory lending occurs in the "subprime market," where loans are sold to people with less than ideal credit histories. 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 some common 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 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.

- * 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.

Ask the right questions when shopping 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 ways home buyers can protect themselves from 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.

This information is from the brochure, "Shopping for a Mortgage? Do Your Homework First," published by the NATIONAL ASSOCIATION OF REALTORS® and the Center for Responsible Lending.

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