CITY OF SEATTLE LAUNCHES INITIATIVES AGAINST PREDATORY MORTGAGE LENDING PRACTICES

by Barbara Osinski

The Seattle Office for Civil Rights (SOCR) and the Seattle Office of Housing have joined forces to combat predatory lending practices in our region. SOCR is preparing to hire a full-time Housing Finance Investigator to assist in investigations of predatory lending cases, providing expertise in mortgage industry standards and underwriting practices. The Housing Finance Investigator also will coordinate three region-wide interagency committees, which will focus on:

- Educating the public about predatory practices. Freddie Mac has granted the Office of Housing $25,000 to develop a consumer education program using Freddie Mac's "Don't Borrow Trouble" campaign materials.
- Researching the extent of the predatory practices in our metropolitan area, and
- Developing comprehensive remedies for homeowners who have been victimized by predatory practices.

Subprime lending can be very beneficial. It offers options – especially for first time home buyers – to people who do not qualify for prime rate loans. But a few bad actors in the subprime lending business prey on vulnerable consumers.

The subprime lending market has grown at an unprecedented rate over the past several years. From 1993-1998, the number of subprime refinance loans increased ten-fold, according to the U.S. Dept. of Housing and Urban Development (HUD). HUD also has found that a disproportionate percentage of subprime loans are made in low-income and very low-income neighborhoods and are five times more likely in African-American than in white neighborhoods.

The growth of predatory lending practices has matched the increase in subprime lending. This means that low-income and minority neighborhoods and the elderly are prime targets of predatory lenders.

What is Predatory Lending?

By loading a loan with excessive fees, high interest rates, and pricey insurance premiums on the front end, predatory lenders ensure themselves a pay-off. If the borrower makes the monthly loan payments, which are often inflated (excessive fees, high interest rates, and pricey insurance premiums), the lender makes a profit. If the borrower is unable to make the monthly payments, the lender forecloses and sells the house for a profit. At their worst, predatory lending practices are designed to send a homeowner into foreclosure, or allow the lender to take the property under a deed of trust.

Predatory lenders go beyond risk-based pricing, and instead set loan terms high above what they need to offset costs and to earn a return that compensates for the increased risk. This is typically done through high interest rates, high points, high origination fees, unnecessary credit life insurance, and other additions to the loan. While many of the loan terms described below may not be predatory on their own, the failure of the lender to fully disclose the risks or costs associated with each individual term can make the loan package problematic, especially if the borrower is unaware that better terms may be available. Potentially predatory tactics designed for the benefit of the subprime lender can include:

- Steering borrowers to higher cost loans when they could qualify for a lower-cost loan. (Studies by Freddie Mac and Standard and Poor's indicate that 63% of subprime borrowers would have qualified for conventional "A" or "A-" loans.)
- Locking borrowers into loans they cannot afford, through false promises of lower payments. Sometimes this even occurs through outright fraud, or forging signatures on documents not disclosed to the borrower. A lender may base loan approval on an exaggerated evaluation of the value of the property, resulting in a larger loan than good underwriting practices should allow.
- Stripping borrowers of hard-earned equity with deceptive and inappropriate loan structures and terms. This can be done by structuring the debt with excessive fees and interest rates (beyond those needed to cover costs and reasonable, risk-adjusted returns), by "packing" and financing these excessive fees, and by "flipping" or frequently refinancing with fees being rolled back into the loan.
- Standard mortgage practices taken to an extreme. When "points," "fees" and required insurance coverage are excessive, the loan can be considered predatory. "Loan flipping" is another standard practice that can be taken to an extreme. "Flipping" is selling a loan to another company. This may occur in any loan, and new origination fees may be tacked onto any loan which is "flipped" to a new company. When this happens over and over, the added fees can make the loan unaffordable and increase the likelihood that the homeowner will lose the property.

Some cities and states have tried to implement stronger legislation to prohibit predatory lending. But legislative efforts have been successfully challenged in court. Here in Washington State, our consumer laws have been strengthened to include remedies for some predatory practices. In addition to legislative action to address predatory lending, some other types of assistance to borrowers are available. The State Attorney General's office is taking an interest in predatory lending cases, and the King County Bar Association has trained attorneys to litigate on behalf of borrowers victimized by predatory practices. The State Department of Financial Institutions has the power to settle disputes over predatory practices, and can even revoke a lenders' license if necessary.

SOCR, HUD and all of our local Fair Housing enforcement agencies will accept predatory lending cases which involve violations of the Federal Fair Housing Act or our local fair housing laws.