Fair Housing and Fair Lending
Solutions for the Real Estate Professional

www.mvfairhousing.com/dontrisk
WHY FAIR HOUSING TODAY?

1989 HUD Survey
In 1989, the United States Department of Housing and Urban Development (HUD) commissioned a Housing Discrimination Survey (HDS) to identify and provide an understanding of the barriers of discrimination in the housing market. The HDS measured the treatment of testers posing as homebuyers in 3,800 audits in 25 metropolitan areas. The survey results painted a bleak picture of discrimination in the housing market and indicated differential treatment in all stages of each search.

The survey results, as well as subsequent survey results, indicate that in over half of the visits to housing providers, African-American or Hispanic homebuyers received less favorable treatment than Caucasian homebuyers. This treatment occurred in both sales and rental situations. Differences reported include the number of housing options offered and the level of service provided to homebuyers.

The HDS serves as a reminder that discrimination continues in the housing market today. It affirms the need for the real estate industry to be vigilant in promoting fairness and equal opportunities in housing. A 1999 study by HUD determines the levels of discrimination.

Market Diversity
Today, any acknowledgment of discrimination in the housing industry must be combined with an awareness of the population's increasing diversity. The reality of expanding diversity of our society including non-traditional families, immigrants, aging population, single parents and others make fair housing laws even more important.

According to Harvard University Joint Center for Housing Studies, the U.S. population growth will fall to just .80 percent annually between 2000 to 2010. The population growth will see a relatively fast growth in minority populations (including Hispanics, as well as African-Americans, Asian-Americans, and Native Americans) and a significant slowdown in the Caucasian population growth. This spurt of minority population growth is largely due to immigration or higher rates of natural increase. As a result, the U.S. population will become increasingly diverse over the next 15 years.

The minority share of the overall population is expected to expand from 24 percent in 1990 to 32 percent in 2010. Housing trends estimate the Asian population will post the highest growth rate of all racial and ethnic groups. In the 1990s thus far, immigrants have accounted for almost one-third of the overall population growth. In total, the minority population will increase by 16.8 million in the 1990s and 17.8 million in the first decade of the 21st century. Source: The State of the Nation's Housing 1996 Harvard University Joint Center for Housing Studies.

The growing diversity of households in the United States will profoundly affect the role of real estate professionals to provide equal service to all customers and clients. Working with a diverse customer/client base expands business opportunities.
FAIR HOUSING LAWS

What is Fair Housing?

OVERVIEW
Title VIII of the Civil Rights Act of 1968, commonly referred to as the Fair Housing Act, was passed on April 11, 1968. The legislation was pending in Congress for several years when the assassination of Dr. Martin Luther King, Jr. motivated Congress to approve and enact the law seven days after his death. The Fair Housing Act of 1968, as amended in 1988 (42 U.S.C. § 3601 et seq.), the Civil Rights Act of 1866 (42 U.S.C. §1981, 1982), and four Supreme Court decisions provide the legal foundation for the fair housing movement. These laws prohibit all race discrimination in housing and provide protection for other groups seeking to rent or buy a home, secure a mortgage loan or purchase homeowner’s insurance. These laws also protect people from harassment in housing and protect people who help others exercise their freedom to choose the neighborhood where they live.

The federal Fair Housing Act prohibits discrimination on the basis of race, color, religion, sex, disability, family status, and/or national origin (42 U.S.C. § 3604). These bases of protection are commonly referred to as protected classes. The federal Fair Housing Act enumerates a number of actions and practices that are illegal when found to discriminate or cause discrimination against a member of a protected class. It is illegal to:

- Refuse to sell or rent a property to a person because of his/her membership in a protected class;
- Discriminate in the terms, conditions and/or privileges of sale or rental because of membership in a protected class;
- Discriminate in advertising, specifically to make, print, publish, or cause to be made, published or printed, any notice, statement or advertisement that indicates any preference, limitation, or discrimination because of membership in a protected class;
- Misrepresent the availability of housing because of a person’s membership in a protected class;
- Engage in blockbusting or steering. Blockbusting is designed to induce panic in a neighborhood by telling a homogeneous group in a community that others like them are leaving because a group of people representing a protected class are moving into the neighborhood and thereby changing or destroying the neighborhood and community. Steering occurs when housing providers direct renters or buyers to a certain neighborhood because of their protected class status;
- Refuse to accommodate people with disabilities by allowing them to make reasonable modifications to housing;
- Discriminate in making loans for real estate transactions including purchasing, constructing, improving, repairing and/or maintaining a dwelling; and
- To coerce, intimidate, threaten, or interfere with any person in the exercise or enjoyment of a fair housing right or any person who has aided or encouraged any other person in the exercise or enjoyment of a fair housing right.
The Fair Housing Act uses the term “handicap,” rather than the more commonly used term, “disability.” The definition of “handicap” in the Fair Housing Act is the same as the definition of “disability” in the Americans with Disabilities Act (ADA). However, the Fair Housing Act applies to housing, and the ADA applies to employment and access to commercial establishments such as real estate sales offices and boards of REALTORS®.

**Fair housing laws protect everyone**
Your instructor will provide information of any additional protected classes in this location. States and municipalities may have state/local fair housing laws that may include additional protected classes.

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Currently, federal fair housing laws protect seven classes of persons. State and municipal laws may protect other classes. Examples of additional classes protected by state and local governments include age, source of income, occupation, marital status, sexual orientation, and unfavorable discharge from the military.

**Which Law Prevails?**

What if, for example, the local law does not prohibit discrimination based on handicap, but the federal law does? The federal law prevails. Federal statutes should be considered as the minimum laws. However, you must comply with local, state, and federal laws at all times. An overall rule of thumb is to comply with the law that places the greatest burden or provides the greatest protection against discrimination.

**HISTORICAL BACKGROUND**

**Historical Presentation and Discussion**
Federal fair housing laws prohibit housing discrimination based on race, color, religion, sex handicap, familial status, or national origin. This is a culmination of many earlier laws and constitutional rights to ensure all citizens the freedoms and liberties they deserve.
**Supreme Court Decisions**
1789 — United States Constitution
1856 — Dred Scott Decision
1866 — 13th and 14th Amendments to the United States Constitution
1866 — Civil Rights Act
1874 — Plessy V. Ferguson
1968 — Federal Fair Housing Act
1974 — Fair Housing Act Amendment
1988 — Fair Housing Act Amendment
1995 — Congress clarified the Housing for Older Persons exemption

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**DECLARATION OF INDEPENDENCE**
The Declaration of Independence affirms, “all men were created equal,” but the U.S. Constitution said that slaves were considered to be “three-fifths” of a person.

**Dred Scott Case**
As a result of the Dred Scott decision in 1856, the Supreme Court determined that black persons had only the rights or privileges granted by those who held the power or the government, and had no rights, which “the white man was bound to respect.”

**13th and 14th Amendments**
After the War Between the States, there was a flurry of legislative activity about granting full citizenship to former slaves.
The 13th amendment, ratified in 1865, abolished slavery.
The 14th Amendment, ratified in 1870, guaranteed all persons due process and equal protection under the law.

**Civil Rights Act of 1866**
Enacted by the Reconstruction Congress, the 1866 Civil Rights Act specifically guarantees that all US citizens have the same right to “inherit, purchase, lease, sell, hold and convey real and personal property as is enjoyed by white persons.”

**Plessy V. Ferguson**
In 1896, a Supreme Court decision effectively halted any further development toward true racial equality by holding that “separate but equal” facilities are constitutionally permissible. In 1954, by the Brown v. (Topeka, Kansas) Board of Education, the decision was reversed.
Fair Housing Act

Civil Rights Act of 1968
Title VIII of the Civil Rights Act of 1968, now known as the Fair Housing Act, was specifically enacted to prohibit discrimination in housing and was the beginning of a comprehensive body of statutes governing private and public housing in the United States.

Fair Housing Act Amendments
  - A 1974 Amendment added “sex” whether male or female, as a protected group.
  - A 1988 Amendment added “handicap” and “familial status” as protected groups and made changes in enforcement of the law, which will be covered later in the course.
  - 1995 – Congress clarified the Housing for Older Persons exemption.

The Civil Rights Act of 1866 and the Federal Fair Housing Act of 1968, as amended, are the foundation of fair housing law in the United States.
Pertinent Civil Rights Legislation for Fair Lending

(1) **Equal Credit Opportunity Act (ECOA)**

- Prohibits discrimination based on *race, color, religion, national origin, sex, Marital status, age, receipt of public assistance, and exercise of rights under the Consumer Credit Protection Act.*
- Prohibits discrimination, on the basis of the above characteristics, “with respect to any aspect of a credit transaction.” Creditors may not single out a protected group for unusually bad credit terms (“reverse redlining”), or because income is from public assistance or because a right has been exercised under the Consumer Credit Protection Act.
- Remedies include actual damages, punitive damages up to $10,000 in individual cases, and attorney’s fees. Administrative enforcement is under the jurisdiction of the U.S. Department of Justice.

(2) **Title VIII (Fair Housing Act of 1988)**

- Forbids discrimination due to *race, color, national origin, religion, sex, familial status,* and *handicap.*
- Prohibits discrimination in all aspects of residential real-estate related transactions. It applies to the making of loans to buy, build, or improve a home; the purchasing of real-estate loans; selling, brokering or appraising residential real estate; selling or renting of a dwelling; and homeowners insurance transactions. One cannot be denied a loan for the purpose of purchasing, constructing, improving, repairing, or maintaining a dwelling, or discriminate in fixing the amount, interest rate, duration, application procedures, or other terms or conditions of such a loan, or in appraising property.
- Remedies include injunctive relief, actual damages, punitive damages, and attorneys fees. Administrative enforcement is under HUD jurisdiction.

(3) **Civil Rights Act of 1866 (§42 U.S.C. Section 1981 and Section 1982)**

- **Section 1981** guarantees all *persons* in the U.S. the same rights as white citizens to make and enforce contracts.
- **Section 1982** guarantees all *citizens* the same rights as white citizens to purchase, lease, sell, hold and convey real and personal property.
- Unlike the ECOA and the FHA, which protect against unintentional discrimination as well as intentional discrimination, the Civil Rights Acts only pertain to *intentional discrimination.* Like the ECOA and the FHA, actual damages, injunctive relief, punitive damages and attorney’s fees are available remedies.
(4) **Americans with Disabilities Act (ADA)**

- Prohibits discrimination against persons with disabilities in the full enjoyment of goods, services, facilities, privileges, advantages or accommodations by any person who owns, leases, or operates a place of public accommodation. Public accommodation includes banks.
- For example, a retailer cannot ask about disability on a credit application. While the ADA does not define “goods and services,” that language has been held to include credit under some states laws.

(5) **Community Reinvestment Act (CRA)**

- The Community Reinvestment Act (CRA) (12 USC 2901 et seq.) encourages certain regulated financial institutions to help meet the credit needs of their entire communities, including low-and moderate-income neighborhoods, consistent with safe and sound operations. Congress passed the CRA in 1977 to end the practice of “redlining,” or the denial of credit on property because of the property’s location in low-income and minority neighborhoods.

(6) **Home Mortgage Disclosure Act (HMDA)**

- The Home Mortgage Disclosure Act (HMDA) was enacted by Congress in 1975 and is implemented by the Federal Reserve Board’s Regulation C, (12 CFR 203). This regulation provides the public with loan data that can be used to assist:
  - In determining whether financial institutions are serving the housing needs of their communities;
  - Public officials in distributing public-sector investments so as to attract private investment to areas where it is needed; and
  - In identifying discriminatory lending patterns. ALSO see Appendix H: *Improvements in HMDA*

(7) **State of Ohio Fair Housing Law Chapter 4112 of O.R.C.**

- The State of Ohio enacted equivalent Fair Housing legislation in June of 1992. This law is comprehensible and on some subjects is **stronger than the Federal Fair Housing Law.**
  The primary agency responsible for enforcing the state Fair Housing Law is the Ohio Civil Rights Commission. The Fair Housing Law for Ohio covers a broad range of prohibitions against discrimination including:
  - Refusal to sell, rent, or negotiate for the sale or rental of a house or an apartment or otherwise make housing unavailable.
Discrimination in the terms or conditions for buying or renting a house or apartment.

Denying or making difficult terms for home loans by commercial lenders, such as banks, savings and loan associations or insurance companies.

Denying anyone the use of real estate services, such as a broker or multiple listing service.

**Regulatory Legislation and Fair Lending**

*Real Estate Settlement Procedures Act 12 U.S.C. §2603 et seq*

*(RESPA)*; this is the law that established the Uniform Settlement Statement or better known as the required HUD-1 at closing. Some provisions are:

- Whenever loan is sold, borrower must be informed 15 days in advance, called Notice of Assignment

- No later than 3 business days after application, the consumer must be given a Good Faith Estimate and a booklet explaining the costs.

- Regulates how escrow is set up

- 2603(b)(2): Upon the request of the borrower to inspect the form prescribed under this section [HUD-1] during the business day immediately preceding the day of settlement, the person who will conduct the settlement shall permit the borrower to inspect those items which are known to such person during such preceding day

- HUD-1 that clearly and conspicuously itemizes all charges must be provided at closing

- Qualified “written request” for information such as payment history, explanation of charges, allocation of principal and interest, imposition of late fees, etc.: a tool used by investigators after closing, lender must acknowledge receipt within 20 business days and comply by providing requested information within 60 business days

- Broad prohibition against unearned fees, e.g. Yield Spread Premium (YSP), kickbacks of any sort, etc.
TILA: Truth and Lending Act 15 USC §1601

There are different rules under TILA for open-ended credit, like credit cards, and close-end credit, like home mortgages. This discussion only looks at close-end mortgages.

- TILA is primarily a disclosure statute.
- The underlying premise of TILA is to provide consumers with accurate information concerning the cost of credit.
- The failure to disclose certain information correctly triggers either TILA statutory or actual damages.
- TILA violations are not always apparent on the face of documents. [One] must check the facial validity and then look behind all charges imposed to see if they in fact meet the requirements for being excluded from the finance charge. Example: total finance charges must be disclosed. **Total Finance Charge Definition:** Consists of all charges payable directly or indirectly by the consumer and imposed directly or indirectly by the creditor as an incident to or a condition of the extension of credit.

**Examples of things to look for behind the charges:**

If credit insurance is voluntary, does a separate disclosure statement disclose the voluntary character?

**Other things that need to be reviewed are:**

1. Check disclosures for accuracy.
2. Review schedule of disbursements to determine creditors allocations between amounts financed and finance charges.
3. Review notice of right to cancel

This explanation of TILA is just to give an overview and sense of what the law is about. It is not meant to be completely definitive. TILA is very complicated. Suspicious-looking disclosure statements need to be reviewed by a professional.

RICO: Racketeering and Corrupt Organizations Act 18 USC §1961 TO §1968

Federal and state RICO statues provide important alternative to state UDAP [i.e. CSPA laws] remedies in cases of abusive consumer practices. In Ohio, CSPA laws exempt lending Institutions.

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The following are a few common elements to a RICO civil action:

- Enterprise affects interstate or foreign commerce (mail fraud e.g.)
- The prohibited conduct caused injury to the plaintiff’s business or property
- The case involves either “collection of an unlawful debt” or “Racketeering activity”

Although there is not yet consistency in how courts view challenges to consumer credit practices under RICO, there are examples that the court has concluded that a RICO claim is appropriate.

A well-plead allegation of loan flipping may state a claim for mail fraud under RICO. RICO can provide a remedy when a lender misrepresents that a rate is better than other lender’s rates, or that a loan will pay off other debts when it will not.

A borrower may successfully plead a RICO claim in a yield spread premium case. The elements of RICO are satisfied where the payment of the premium is not disclosed and the cost of the premium is passed on to the borrower in the form of a higher interest rate, and where the broker represented that it would provide the lowest available mortgage rate, money flowed between the assignee, the funding lender, the broker, and its related title company, and the mails were used in furtherance of this scheme.

**Home Ownership Equity Protection Act (HOEPA) 15 U.S.C. §1602aa**

Passed in 1994, HOEPA was intended to curb the most egregious lending practices. The loan becomes a HOEPA loan under certain criteria.

**Applicability:**

1. Limited to non-purchase, close-ended loans secured by residential property,
2. Must meet either “points and fees trigger” of 8% or
3. Must meet “APR Trigger” whereas a loan exceeding a comparable U.S. Treasury security by 10% qualifies for HOEPA protection.

To Illustrate:

- If 30 year bond pays 5% and
- If a 30 year fixed mortgage has an APR of 15.5%, this mortgage qualifies as a HOEPA Loan.

**Substantive Protections:**

1. Early and Extra Disclosure: HOEPA requires a notice to the borrower three (3) days before closing. Referred to as the cooling off period, this “Section 32 notice” will identify the loan as high cost and indicate to the borrower that default can result in losing one’s home.
2. Balloon payments due less than 5 years are prohibited; negative amortization prohibited
3. In general, prepayment penalties are prohibited, even though there is a complex 5-part exception to this provision
4. Acceleration of borrower’s interest rates upon default are prohibited
5. Asset-based lending is somewhat prohibited – for this to be enforced, the borrower needs to prove the lender engages in a “pattern or practice of extending credit to consumers [in covered HOEPA loan] based on the consumers’ collateral without regard to the consumers’ repayment ability, including the consumer’s current and expected income, current obligations and employment. This stipulation makes the provision difficult to enforce.
6. Payment of home improvement contractors without Homeowner’s consent is stringently regulated
7. The Federal Reserve Board is given broad power to prohibit unfair and deceptive practices.

Sub-Prime Market Overview

For a Broker, Lender or Investor to successfully produce/purchase or sell sub-prime loans, **PROPERLY ASSESSING & PRICING THE RISK IS CRUCIAL.** With a performance history on sub-prime loans, we are now able to define the areas that are creating a higher risk than anticipated. *Higher prepays, delinquencies & defaults than expected point to several factors;*

- Loans are not consistently & properly underwritten at the origination stage as well as during due diligence. (After the loans are closed and being offered for sale to another lender or investor.)
- Lack of Quality Control prior to and after funding.
- Fraud.
- Lack of accountability in the process.
- Aggressive programs that underwriting cannot save.
- Poor servicing. (The collection of the monthly payments from the borrower.)

**Poor Underwriting (In order of the most common issues)**

- Inaccurate and/or inconsistent grading
- Lack of common sense.
- The loan provides minimal or no clear advantage to the borrower. *(Section 32 loans not identified or disclosures signed.)*
- Exceptions that are not warranted.
- Lack of documentation to support file.
- Too many conditions.
• Property values are not supported.
• Unacceptable properties.
• File does not clearly show how the underwriter reached their decision.

Poorly underwritten loans = Poor pricing to the seller.
Continually poorly underwritten loans = Lack of Investors to purchase the loans with poor pricing to the seller.

Conforming Loan Definition

"A" Paper / Conventional / Conforming Loan

• A residential loan that has been evaluated for credit risk based on standardized underwriting guidelines and criteria. Widespread use of automated underwriting programs creates consistency in credit decisions. The criteria/guidelines used are based on analysis of payment performance of mortgages over many years. Full documentation programs are standard with alternative documentation programs available for borrowers that refinance with an excellent mortgage payment history.

• These loans have a low risk factor as generally these borrowers exhibit good to excellent payment habits, have some cash reserves and exhibit stable employment with their income supporting the required debt to income ratios.

• Loan to values (LTV) up to 100%. (LTV is a percentage representation of the remaining equity in a property. This is determined by dividing the loan amount into the appraised value. Example – Loan Amount of $150,000.00 is divided into the value of the property, $200,000.00. The loan to value is 75%, meaning 75% of the property is leveraged, leaving 25% remaining equity.)

• The FICO score is typically above 620. FICO scores are regularly used in underwriting.

• The program, rate, points and fees paid to the Broker and/or Lender generally stays within the acceptable parameters for the industry. Competition among lenders will often create better rates and programs for the borrower.

• Fannie Mae & Freddie Mac drive the market.

• Retail loans (lender has direct contact with the borrower) made up 35% of the total volume of loans in 1997.*

• Broker loans/3rd party loans (Lender receives the loan from the Broker and generally has no direct contact with the borrower during the loan process. The Broker has relationships
with many different lenders and seeks to find the best loan for the borrower.) made up 26% of the total volume of loans in 1997.*

- Correspondent loans (Broker/3rd party has a relationship with a Lender that provides funds for the Broker to fund the loan in their name. The legal instruments are assigned to the Lender when the loan closes. This relationship allows the Broker to expedite closing.) made up 39% of loans from 1997.*

- 87% of the loans in the first quarter of 1998 are fixed rate loans. 13% are adjustable rates.*

* Figures from “Inside B & C Lending” 6-8-98 issue.

**CREDIT SCORE**

660 & HIGHER – Fannie/Freddie Approval
620 to 660 – Fannie/Freddie need to review
620 to 640 – A-
590 to 620 – B
550 to 590 – C
549 to 530 – C-
530 & lower – D

**Sub-Prime Loan Definition**

**B/C PAPER / NON-CONFORMING / SUB-PRIME LOAN**

- A residential loan that does not meet the “A” paper requirements and has been evaluated for credit risk based on underwriting guidelines/criteria established by an investor and/or lender. Automated underwriting is not consistently used. The guidelines/criteria are created from the investor’s definition of “acceptable risk” based on the rate, LTV and program. Higher rates and lower LTV’s are desired factors to offset the risk to the investor. Reduced documentation programs are regularly used.

- These loans have a higher risk factor and the borrower exhibits fair to poor payment habits. Instability in income is often a factor with high debt to income ratios. Cash reserves are generally not present nor required by the investor.

- Total loan to value (TLTV) up to 135%. (Total loan to value (TLTV or CLTL (combined loan to value) is the amount of all liens against the property, divided into the appraised value.)
• The FICO score is under 620. FICO scores are not regularly used in underwriting. They typically are required on higher LTV product. (Above 80%)

• Higher rates, points and fees paid to the Broker and/or Lender vary widely. Even higher rates, points and fees are typically in areas where there is minimal competition. Competition among lenders may create better rates for the borrower but generally it creates more flexibility in the guidelines with aggressive, inconsistent underwriting. Credit quality degenerates.

• Several investors drive the market. This creates inconsistency, as each investor criteria may be different. Investor criteria are often relaxed when there is a need for volume. With the entrance of larger conventional lenders and investors in the market, greater consistency is expected. Higher LTV product (over 80%) shows more consistency in documentation and underwriting.

• Retail loans made up 26% of the volume of loans in the first quarter of 1998.*

• Broker/3rd party loans made up 37.5%. Correspondent loans=36.5%*  

• 48.6% of loans in the first quarter of 1998 are adjustable loans.*  

• 51.40% are fixed rate loans.

**Consumer/Positive**

• Financing is now available to the consumer who was previously declined or had to pay extremely high rates and fees at a low LTV. (Hard Money Loans)
• Reasonable financing is now possible for: *Cash Out Refinance* – Home Improvements, Debt Consolidation, Personal Needs (Vacation, Health Costs, etc.), Savings, Retirement Plans, Pay Off Judgments, IRS
• *Purchase* – 1st Time Home Buyers
• Competition among lenders results in better rates, higher LTV’s, lower fees, flexible underwriting, and faster closings, as well as alternative and “no” document loans.

“Everyone is approved”

• Credit scoring is not typically used and the consumer is given the opportunity to repair prior negative credit while improving their credit score. This will enable the consumer to obtain conforming rates and fees in the near future. (Approx. 1 year, assuming all payments are made on time.) The consumer with no credit is able to “build” a credit profile with non-traditional sources for credit ratings. (Utility Bills, Personal Loans, etc.) The mortgage rating or
landlord rating drives the credit grade, meaning that more consideration is
given to how the consumer pays their mortgage over how they pay their
other accounts.
- The success of Sub-Prime Financing has caused traditional “A”
paper/conforming lenders/investors to re-evaluate their underwriting
criteria and standards, resulting in more financial options for consumers.
- More lenders/investors = More choices and control to the consumer.

**Consumer/Negative**

- The consumer is taken advantage of via higher rates and fees because of
their credit or employment/income situation.

**INTIMIDATION**

It is embarrassing for most people to discuss or admit that they have credit
and/or income problems. Lenders may use this to their advantage by not
explaining the programs, etc. or not answering questions the consumer may
have. Often times the consumer will not ask questions due to the unreasonable
fear that their questions may stop them from getting a loan, or they may think
that their questions are stupid.

- The consumer may not know the program, rate or fees on their loan
  until the closing.
- Some consumers with subprime financing actually may qualify for
  conforming programs and rates.
- Lack of education or financial sophistication makes many consumers
  an easy target for unscrupulous lenders.

- While competition among lenders creates more favorable conditions for the
  consumer, the lack consistency continues to reduce the amount of investors
to but these loans. A “B” loan to one lender may be a “C” loan to another,
there needs to be a consistent way to assess the risk. Many consumers are
approved for a loan when they should not be. Often times the result is that
the consumer goes into foreclosure or struggles with their payments, making
them late. Credit Scoring is being used more and more in subprime to
provide investors with a consistent measuring tool. The result to the
consumer will be fewer programs available, and they may end up in a higher
risk category with higher rates, etc.

**CONSUMERS NEED TO BE EDUCATED ON THEIR OPTIONS IN THE SUBPRIME MARKET!!!!!!**
Predatory Lending: Warning Signs for Realtors

Lender profile/practices:

• “Guaranteed approval” regardless of borrower’s financial status
• The closing date is unreasonably stretched
• Borrowers are steered to higher cost loans in spite of qualifying for market rate products
• The loan officer refuses to provide Good Faith Estimate
• There is a large discrepancy between the Good Faith Estimate and the HUD-1 settlement statement
• The lender does not charge an application fee
• The loan officer works out of his/her home, rather than an office
• The lender offers the agent or agency a “kickback” for referrals

The loan includes:

• Excessive fees and/or interest rate
• Below market interest rate
• A short rate-lock period
• Reference to Section 32, a trigger for high cost loans
• Excessive pre-payment penalties
• A balloon payment
• Up-front cost for credit life insurance
• Unnecessary fees
• Undisclosed fees and/or terms
• Different terms presented at closing

Other indicators:

• Inflated appraisals
• Appraisal doesn’t match the comparative market analysis
• Fraudulent 2nd mortgages
• The preliminary title report reveals a different owner
• Documents have been forged
Predatory Lending: Solutions for Realtors

*Recommended practices to avoid predatory lending:*

- Educate buyers and sellers about predatory lending
- Share horror stories with borrowers and other agents
- Encourage borrowers to shop for the best financing terms among multiple lenders
- Research lenders through the Better Business Bureau, length of time in business, and membership in reputable trade organization such as the Mortgage Banker’s Association
- Form a list of reputable lenders
- Help sellers evaluate the buyer’s offer (it may be a good idea to reject a “shaky” offer)
- Make the contract subject to specific financing parameters
- Encourage back-up offers
- Refuse unnecessary contract extensions
- Do a comparative market analysis
- Check the HUD-1 settlement statement *before* closing
- Encourage buyers and sellers to use a reputable attorney
- Report violations of professional standards to the appropriate governing bodies
- Refuse to participate in fraudulent transactions

*Resources:*

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<td><a href="http://www.hud.gov/fha/predlend.html">www.hud.gov/fha/predlend.html</a></td>
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(for a list of foreclosures, click on departments, sheriff’s office, properties for sale)
Glossary of Terms
Predatory Mortgage Lending Abuses

The following is a catalogue of predatory mortgage lending abusive practices. We have divided the practices into abuses with the origination of the loan, servicing of the loan, and collection of the loan.

I. ORIGINATION OF LOAN

1. Solicitations. Predatory mortgage lenders engage in extensive marketing in targeted neighborhoods. They advertise through television commercials, direct mail, signs in neighborhoods, telephone solicitations, door to door solicitations, and flyers stuffed in mailboxes. Many of these companies deceptively tailor their solicitations to resemble social security or other U.S. government checks to prompt homeowners to open the envelopes and otherwise deceive them regarding their predatory intentions.

2. Home Improvement Scams. Predatory mortgage lenders use local home improvement companies essentially as mortgage brokers to solicit business. These companies solicit homeowners for home improvement work. The company may originate a mortgage loan to finance the home improvements and then sell the mortgage to a predatory mortgage lender, or steer the homeowner directly to the predatory lender for financing of the home improvements. The home improvements are often grossly overpriced, and the work is shoddy and incomplete. In some cases, the contractor fails to obtain required permits, thereby making sure the work is not inspected for compliance with local codes.

3. Mortgage Brokers – Kickbacks. Predatory mortgage lenders also originate loans through local mortgage brokers who act as bird dogs (finders) for the lenders. Many predatory mortgage lenders have downsized their operations by closing their retail outlets and shifting the origination of loans to these brokers. These brokers represent to the homeowners that they are working for the homeowners to help them obtain the best available mortgage loan. The homeowners usually pay a broker’s fee. In fact, the brokers are working for predatory mortgage lenders and being paid kickbacks by lenders for referring the borrowers to the lenders. On loan closing documents, the industry employs euphemisms to describe these referral fees: yield spread premiums and service release fees. Also, unbeknownst to the borrower, his interest is raised to cover the fee. Within the industry, this is called bonus upselling or par-plus premium pricing.

4. Steering to High Rate Lenders. Some banks and mortgage companies steer customers to high rate lenders, including those customers who have good credit and would be eligible for a conventional loan from that bank or lender. In some cases, the loan application is wrongfully denied and the customer is referred to a high rate lender. The high rate lender is often an
affiliate of the bank or mortgage company, and kickbacks or referral fees are paid as an incentive to steer the customer to the lender.

5. **Lending to People Who Cannot Afford the Loans.** Some predatory mortgage lenders purposely structure the loans with monthly payments which they know the homeowner cannot afford with the idea that when the homeowner reaches the point of default, he will return to the lender to refinance which provides the lender additional points and fees. Other predatory mortgage lenders, whom we call hard lenders, purposely structure the loans with payments the homeowners cannot afford in order to trigger a foreclosure so that they may acquire the house and the valuable equity in the house at the foreclosure sale.

6. **Falsified Loan Applications, Unverified Income.** In some cases, lenders knowingly make loans to homeowners who do not have sufficient income to repay the loan. Often, such lenders wish to sell the loan to an investor. To sell the loan, the lender must make the loan package have the appearance to the investor that the borrower has sufficient income. The lender has the borrower sign a blank loan application form. The lender then inserts false information on the form (for example, a job the borrower does not have), making the borrower appear to have higher income than he actually has.

7. **Adding Co-Signers.** This is done to create a false impression that together both borrowers have sufficient income to be able to pay off the loan, even though the lender is well aware that the co-signer has no intention of contributing to the repayment of the mortgage. Often, the lender requires the homeowner to transfer half ownership of the house to the co-signer. The homeowner has lost half the ownership of the home and is saddled with a loan he can't afford to pay.

8. **Incapacitated Homeowners.** Some predatory lenders make loans to homeowners who are clearly mentally incapacitated. They take advantage of the fact that the homeowner does not understand the nature of the transaction or the papers that he/she signs. Because of his/her incapacity, the homeowner does not understand he/she has a mortgage loan, does not make the payments, and is subject to foreclosure and subsequent eviction.

9. **Forgeries.** Some predatory lenders forge loan documents. In an ABC Prime Time Live news segment that aired on April 23, 1997, a former employee of a high cost mortgage lender reported that each of the lender’s branch offices had a “designated forger” whose job it was to forge documents. In such cases, the unwary homeowners are saddled with loans they know nothing about.

10. **High Annual Interest Rates.** The very purpose of engaging in predatory mortgage lending is to reap the benefit of high profits. Accordingly, these lenders always charge unconscionably high interest rates, even though their risk is minimal or non-existent. Such rates drastically increase the cost of borrowing for homeowners. Predatory mortgage lenders routinely charge Atlanta area borrowers rates ranging from 12% to 18%, while other lenders charge rates of 7.0% to 7.5%.
11. **High Points.** Legitimate lenders charge points to borrowers who wish to buy down the interest rate on the loan. Predatory lenders charge high points but there is no corresponding reduction in the interest rate. These points are imposed through prepaid finance charges (or points or origination fees), and are usually 5 to 10% of the loan, and they may be as much as 20% of the loan. The borrower does not pay these points with cash at closing. Rather, the points are always financed as part of the loan. This increases the amount borrowed, which produces more annual interest to the lender.

12. **Balloon Payments.** Predatory mortgage lenders frequently structure loans so that at the end of the loan period, the borrower still owes most of the principal amount borrowed. The last payment balloons to an amount often equal to 85% or so of the principal amount borrowed. Over the term of the loan, the borrower’s payments are applied primarily to interest. The homeowner cannot afford to pay the balloon payment at the end of the term, and either loses the home through foreclosure or is forced to refinance with the same or another lender for an additional term at additional cost.

13. **Negative Amortization.** This involves a system of repayment of a loan in which the loan does not amortize over the term. Instead, the amount of the monthly payment is insufficient to pay off accrued interest and the principal balance therefore increases each month. At the end of the loan term, the borrower owes more than the amount originally borrowed. A balloon payment at the end of the loan is often a feature of negative amortization.

14. **Padded Closing Costs.** In this scheme, certain costs are increased above their true market value as a method of charging higher interest rates. Examples include charging $350 for document preparation or credit report fees of $150, both of which are many times the actual cost.

15. **Inflated Appraisal Costs.** This is another padding scheme. In most mortgage loan transactions, the lender requires that an appraisal be done. Most appraisals include a typical, detailed report of the condition of the house (interior and exterior) and prices of comparable houses in the area. Others are “drive-by” appraisals, done by someone driving by the houses. The former naturally cost more than the latter. In some cases, borrowers are charged a fee for an appraisal which should include the detailed report, when only a drive-by appraisal was done.

16. **Padded Recording Fees.** Mortgage transactions usually require that documents be recorded at the local courthouse. State or local laws establish the fees for recording the documents. Mortgage lenders typically pass these costs on to the borrower. Predatory mortgage lenders often charge the borrowers a fee in excess of the actual amount required by law to record the documents.

17. **Bogus Broker Fees.** In some cases, predatory lenders charge borrowers broker fees when the borrower never met or knew of the broker. This is another way such lenders increase the cost of the loan for the benefit of the lender.
18. **Unbundling.** This is another way of padding costs by breaking out and itemizing charges which are duplicative or should be included under other charges. An example is where a lender imposes a loan origination fee, which should cover all costs of initiating the loan, but then imposes separate, additional charges for underwriting and loan preparation.

19. **Credit Insurance – Insurance Packing.** Predatory mortgage lenders market and sell credit insurance as part of their loans. This includes credit life insurance, credit disability insurance, and involuntary unemployment insurance. The premiums for this insurance are exorbitant. In some cases, lenders sell credit life insurance covering an amount which constitutes the total of payments over the life of the loan rather than the amount actually borrowed. The payout of claims is extremely low compared to the revenue from the premiums. The predatory mortgage lender often owns the insurance company, or receives a substantial commission for the sale of the insurance. In short, credit insurance becomes a profit center for the lender and provides little or no benefit to the borrower.

20. **Excessive Prepayment Penalties.** Predatory mortgage lenders often impose exorbitant prepayment penalties. This is done in an effort to lock the borrower into the predatory loan for as long as possible by making it difficult for him/her to refinance the mortgage or sell the home. Another feature of this practice is that it provides back end interest for the lender if the borrower does prepay the loan.

21. **Mandatory Arbitration Clauses.** By inserting pre-dispute, mandatory, binding arbitration clauses in contractual documents, some lenders attempt to obtain unfair advantage of their borrowers by relegating them to a forum perceived to be more favorable to the lender than the court system. This perception exists because discovery is not a matter of right but is within the discretion of the arbitrator; the proceedings are private; arbitrators need not give reasons for their decisions or follow the law; a decision in one case will have no precedential value; judicial review is extremely limited; a lender will be a frequent user while the consumer is a one time participant; and injunctive relief and punitive damages will not be available.

22. **Flipping.** Flipping involves successive, repeated refinancing of the loan by rolling the balance of the existing loan into a new loan instead of simply making a separate, new loan for the new amount. Flipping always results in higher costs to the borrower. Because the existing balance of one loan is rolled into a new loan, the term of repayment is repeatedly extended through each refinancing. This results in more interest being paid than if the borrower had been allowed to pay off each loan separately. A powerful example of the exorbitant costs of flipping is the case of Bennett Roberts, who had eleven loans from a high cost mortgage lender within a period of four years. See, Wall Street Journal, April 23, 1997, at 1. Mr. Roberts was charged in excess of $29,000 in fees and charges, including ten points on every financing, plus interest, to borrow less than $26,000.

23. **Spurious Open End Mortgages.** In order to avoid making required disclosures to borrowers under the Truth in Lending Act, some lenders are making “open-end” mortgage
loans. Although the loans are called “open-end” loans, in fact they are not. Instead of creating a line of credit from which the borrower may withdraw cash when needed, the lender advances the full amount of the loan to the borrower at the outset. The loans are non-amortizing, meaning that the payments are interest only so that no credit will be replenished. Because the payments are applied only to interest, the balance is never reduced.

24. Paying Off Low Interest Mortgages. A predatory mortgage lender usually insists that its mortgage loan pay off the borrower’s existing low cost, purchase money mortgage. The lender is able to increase the amount of the new mortgage loan by paying off the current mortgage and the homeowner is stuck with a high interest rate mortgage with a principal amount which is much higher that necessary.

25. Shifting Unsecured Debt Into Mortgages. Mortgage lenders badger homeowners with telephone and mail solicitations and other advertisements that tout the “benefits” of consolidating bills into a mortgage loan. The lender fails to inform the borrower that consolidating unsecured debt into a mortgage loan secured by the home is a bad idea. The loan balance is increased by paying off the unsecured debt, which necessarily increases closing costs (which are calculated on a percentage basis), increases the monthly payments, and increases the risk that the homeowner will lose the home.

26. Making Loans in Excess of 100% Loan to Value (LTV). Recently, some lenders have been making loans to homeowners where the loan amount exceeds the fair market value of the home. This makes it very difficult for the homeowner to refinance the mortgage or to sell the house to pay off the loan, thereby locking the homeowner into a high cost loan. Additionally, if a homeowner goes into default and the lender forecloses on a loan, the foreclosure auction sale generates enough money to pay off the mortgage loan. Therefore, the borrower is not subject to a deficiency claim. However, where the loan is 125% LTV, a foreclosure sale may not generate enough to pay off the loan and the borrower would be subject to a deficiency claim.

II. SERVICING OF LOAN

1. Force Placed Insurance. Lenders require homeowners to carry homeowner’s insurance, with the lender named as a loss payee. Mortgage loan documents allow the lender to force place insurance when the homeowner fails to maintain the insurance, and to add the premium to the loan balance. Some predatory mortgage lenders force place insurance even when the homeowner has insurance and has provided proof of such insurance, the premiums for the force placed insurance are often exorbitant. Often the insurance carrier is a company affiliated with the lender. Furthermore, the cost of force placed insurance is frequently padded because it covers the lender for risks or losses in excess of what the lender may require under the terms of the mortgage loan.

2. Daily Interest When Payments Are Made After Due Date. Most mortgage loans have grace periods, during which a borrower may make the monthly payment after the due date and
before the end of the grace period without incurring a “late charge”. The late charge is often assessed as a small percent of the late payment. However, many lenders also charge daily interest based on the outstanding principal balance. While it may be proper for a lender to charge interest when the loan so provides, it is deceptive for a lender to charge daily interest when a borrower pays after the due date and before the grace period expires when the loan terms provide for a late charge only after the end of the grace period. Predatory lenders take advantage of this deceptive practice.

III. COLLECTION OF LOAN

1. Abusive Collection Practices. In order to maximize profits, predatory lenders either set the monthly payments at a level the borrower can barely sustain or structure the loan to trigger a default and a subsequent refinancing. Having structured the loans in this way, the lenders consciously decide to use aggressive, abusive collection tactics to ensure that the stream of income flows uninterrupted. (Because conventional lenders do not structure their loans in this manner, they do not employ abusive collection practices.) The collection departments of predatory lenders call the homeowners at all hours of the day and night, send late payment notices (in some cases, even when the lender has received timely payments or even before the grace period expires), send telegrams, and even send agents to hound homeowners in person. Some predatory lenders bounce homeowners back and forth between regional collection offices and local branch offices. One homeowner received numerous calls every day for several months, even after she had worked out a payment plan. These abusive collection tactics often involve threats to evict the homeowners immediately, even though lenders know they must first foreclose and follow eviction procedures. The resulting emotional impact on homeowners, especially elderly homeowners, can be devastating. Being ordered out of a home one has owned and lived in for decades is an extremely traumatic experience.

2. High Prepayment Penalties. See description in I. 20 above. When a borrower is in default and must pay the full balance due, predatory lenders will often include the prepayment penalty in the calculation of the balance due.

3. Flipping (Successive, Repeated Refinancing of Loan). See description in I. 22 above. When a borrower is in default, predatory mortgage lenders often use this as an opportunity to flip the homeowner into a new loan, thereby incurring additional high costs and fees.

4. Foreclosure Abuses. These include:

   (a) persuading borrowers to sign deeds in lieu of foreclosure in which they give up all rights to protection afforded under the foreclosure statute,

   (b) sales of the home at below market value,
(c) sales without the homeowner/borrower being afforded an opportunity to cure the default, and

(d) inadequate notice which is either not sent or backdated.

There have even been cases of “whispered foreclosures”, in which persons conducting foreclosure sales on courthouse steps have ducked around the corner to avoid bidders so that the lender was assured he would not be out-bid. Finally, foreclosure deeds have been filed in courthouse deed records without a public foreclosure sale.