Should you sue your lender?

It will take careful examination of all your mortgage documents to get started. Here are some of the signs you may have a case.
By Christopher Solomon

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As America's subprime lending mess evolves from a storm on the horizon to a real nationwide deluge, an increasing number of homeowners are turning to the courts for help with the loans they can't afford.

Their argument? In a thirst for money, lenders and mortgage brokers have been all too willing to put them into loans that are highly inappropriate for them.

"I guarantee you there are millions of Americans who feel lied to and deceived," says Melissa Huelsman, a Seattle attorney who specializes in cases of predatory lending and foreclosure scams.

You may also think your mortgage is a dog, but how do you know whether you've got a legitimate legal beef with your lender or mortgage broker, or whether you've simply got a burning case of buyer's remorse? The short answer is, it's not always so easy to know. "I hate to give people that sense that, 'Oh, I have a legal claim because I have a loan I can't afford,' " says Kirsten Keefe, executive director of Americans for Fairness in Lending.

Still, several attorneys and consumer advocates who specialize in housing issues say that it's worth re-examining your loan documents carefully -- and the circumstances under which you signed them -- especially if you've got a subprime loan. You may be surprised at what you find.

You might have a legal case if:

- Your broker falsified your income;
- Your broker hid his or her fees;
- You weren't immediately given a copy of the good-faith estimate and weren't given an accurate HUD-1 statement breaking down all fees at closing;
- After signing the contract to refinance your mortgage, you don't walk out with a "notice of rescission" that explains your rights to cancel the refi within three business days;
- You were led into a subprime loan though your credit would've qualified you for a better loan; or
- In short, you were lied to or deceived.

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"The bottom line is, are you in a loan that you can't afford, and were the terms of the ultimate loan really different than what you were told you were getting, and what you understood you were getting?" says Keefe.

For too many borrowers in trouble, the answer is a resounding yes. Here are some common red flags to look for in deciding whether you may have legal recourse:

The multiproblem refi

Sometimes, says David Leen, a Seattle attorney who deals largely with consumer-finance-related issues, several potential problems can emerge in one mortgage deal, starting with the deal itself: A troublesome pitch Leen frequently sees is "where a broker calls up someone and says he can lower payments, lower the interest rate and you can take some cash out" -- an alluring if unbelievable trifecta.

That's what happened to one of Leen's current clients, Jim, who asked that his full name not be used. Jim and his wife have lived in their Seattle home since 1974. They got a phone call in June 2006 from a mortgage broker. "They just called me out of the blue, you know. And we had thought about refinancing," Jim says. "The guy came out to the house and he told me -- I had 6 1/4% interest loan at the time -- and he told me he could get me 2% interest for five years, and two months no payment, plus 'I can put $3,000 in your pocket,' " he recalls. "And I'd just come back from vacation, and I thought, 'That would be nice.' "

Problem No.1: Missing paperwork. Jim and his wife, who are both retired, signed some papers right there. "The guy said he'd finish them at the office and send copies," Jim says. "We kept waiting for copies and we never got them, and I kept calling him."

"I literally get a case or two a week where . . . brokers go out to the house and fill out paperwork and say they'll send paperwork, and don't, after they've closed the deal at the house," says Leen. That's against the law, he says. The federal Truth in Lending Act requires that you walk out the door with a "rescission notice" that allows you to back out of your refinance within three days.

Problem No. 2: The good-faith estimate is no good. Finally, a different person came out to Jim's house to explain the deal -- and it didn't look the same at all. "The payments were supposed to be $1,066 a month. But then when he went over it he had $1,300 and some." Also, Jim was told he'd agreed to an adjustable-rate mortgage. "And he had 8% interest at the top of the contract. And I had 6% before (on my old loan). Why would I do that?"

Whether it's a refinance or an original mortgage, the numbers shouldn't change "between the good faith estimate and the loan that you get," Leen says. "There can be no disparities -- or very little. . . . Even a quarter-percent interest is a big deal."

After more runaround, Jim, who's 70 and on disability and a fixed income, sought legal help. But while his attorney prepares his case, he's paying the higher rate. "I don't want to lose my house," Jim says simply. "I understood everything he was explaining that night he was at our home. But when he went back to his office and wrote it up, everything changed." Jim adds, "How can people come in your house and show you an honest face, and turn around and stab you in the back?"

Hidden and misrepresented payments

Sometimes, an unscrupulous lender will say they can lower your monthly payment but they're actually just omitting taxes and escrow payments from their projections. If you agree to a loan and find out after closing that you'll also have to add these costs to your monthly payment, "you could have a cause of action," says Brad Blower, counsel at Relman & Dane, a Washington, D.C., law firm that specializes in fair housing and fair lending. "Most people are concerned what their monthly payment is. They need to pay attention to the fine print" to make sure that these other things are in that payment, too, he says.

While your HUD-1 statement breaks down closing costs, it won't detail whether the lender is escrowing for taxes and insurance, so you won't find it there, explains Blower. Instead, your lender is required to disclose this information at the time of closing in a separate document required by RESPA (the Real Estate Settlement Procedures Act).

"I can't tell you the number of times people were led to believe those costs were included, but they weren't," Blower says.

Brokers who secretly double-dip

Gregory and Paula Sherman ran into a different sort of trouble in June 2003, when they went to refinance their ranch-style home in Chattaroy, Wash. They thought their broker got them a 30-year, $267,200 loan with Kansas City-based NovaStar Financial at a fixed, 8.5% rate. But at the closing, the Shermans were handed documents for an initial 8.625% loan that would adjust upward in just two years. Yet that's not even the basis of the lawsuit, says Ari Brown of Bergman & Frockt, who is representing the Shermans and others in a class-action suit against NovaStar.

"What (the broker) did not tell the Shermans on the good-faith estimate or anywhere else was that in addition to the origination fee of $5,600 she quoted on the good-faith estimate, she was going to get another $5,344 directly from NovaStar in what is known as a yield-spread premium, or YSP," says Brown. In some loans, the lender pays the broker's fees instead of the borrower. In exchange, the borrower pays the lender back through a higher interest rate over the life of the loan. When used properly, this allows borrowers who don't have much cash at closing to wrap the broker's fees into their loan.

But the YSP can be abused. Some unscrupulous brokers and lenders take advantage of this vehicle to collect more fees. The class-action lawsuit the Shermans have joined argues that more than a thousand borrowers in Washington were deceived because the broker collected a second YSP, unbeknownst to them.

The Shermans are paying slightly over $200 a month more as a result of that higher rate, says Brown.

This double-dipping isn't necessarily illegal, but not disclosing it is. Had the YSP been disclosed on the good-faith estimate early in the loan process, the Shermans would have known their broker was making almost $11,000. They could have shopped for a different broker, paying either the broker's fee or a higher interest rate due to a YSP, but not both.

Instead, the lender and the broker waited until the last minute and only disclosed the YSP in the fine print at closing, when it's too late for most borrowers to shop around, says Brown -- who calls this a hallmark of predatory lending practices. The case is set for trial in May in Washington state.

'No-doc' mortgages

As far as attorney Melissa Huelsman is concerned, if you've taken on a so-called "no doc" mortgage, you'd better take a hard look at it. There's a good chance you didn't need it, you paid dearly for it and some funny business was involved.

A "no document" mortgage is just that -- a loan that requires very little documentation of a would-be borrower's income. The loan was originally designed for the self-employed, who don't have much of a paper trail to show their income history. "It's nothing but a tool that has a very limited, narrow legitimate purpose," she says.

Yet, as with the YSP, the tool has been abused, Huelsman says. In no-doc loans (occasionally called "liar's loans"), a mortgage broker sometimes will fill in a false income amount for would-be borrowers. The borrower qualifies for a larger loan, and the broker benefits from a larger commission. "You might think it's an exception," but it's not, insists Huelsman. "This is blatantly wrong, ridiculous stuff -- and it happens. All. The. Time."

If you're a no-doc loan holder, you may have been pleasantly surprised in the short run that your broker helped you get into a larger house. So why should you be concerned in the long run? Because you may have shouldered a loan you can't afford, at a higher interest rate because you're unnecessarily in a riskier kind of loan, and at an even higher interest rate thanks to the broker's larger commission (which you're paying for).

"When a person goes to see a mortgage broker, the mortgage broker has a duty not to lie and deceive them," Huelsman says.

Check your documents. If you realize your income was falsified, do you have a claim? "Yes -- you have been lied to and deceived and have been induced by the mortgage broker to lie about your income."

Get it in writing and study the details

If nothing else, these stories exemplify how important it is to get everything in writing."The mortgage broker and the lender are going to be bound to what they put in writing," says attorney Brown. If anyone tries to change the deal on you later, "then you'll have recourse . . . The easy cases that I get are when the misrepresentation was in writing."

Your HUD-1 statement is the first place to look when you're trying to assess whether you've been duped by your lender. "The best place to start," says Keefe, "is to go to your HUD-1 settlement statement -- that's the document with all the lines on it, generally two pages -- that shows where the money went, and to look where the money went: how much money went to the lender, how much money went to the broker." It will show how many other fees there were, too.

Adds attorney Brown, "Take your good faith estimate and compare it to your HUD-1, and if there are differences, then it's worth looking into further." Contact an attorney familiar with real-estate documents, or an organization that helps homeowners. (A few are listed at the bottom of this page.)

State laws will generally be more helpful in your fight. "Unfortunately the (federal) law does not protect consumers incredibly well," says Ira Rheingold, executive director and general counsel of the National Association of Consumer Advocates. "Federal laws provide only minimal protections for homeowners, and they're based mainly on disclosures." In other words, if all the required information is there, albeit buried, somewhere in the 30 pages of legal documents you're given, "then you don't have a claim," under federal statutes.

And, he adds, "There is no federal law that says that it is illegal for a lender to make a loan to you that cannot afford." Theoretically, there are bank regulators that would take action, "but I wouldn't hold your breath."

Potential legislation is brewing in Congress. In the meantime, you'll have better luck finding legal redress under state laws, which have unfair and deceptive practices acts and fraud statutes. A bill about to be signed into law by Minnesota's governor, said to be the toughest law in the nation, will demand that lenders verify that borrowers can repay a loan. It will prohibit loan refinancings that don't benefit borrower and forbid negative-amortization loans in which the borrower pays only interest at first. That makes the payments more affordable, but all too often only gets the borrowed deeper into debt as a result.

Still, even states have found themselves limited in their ability to protect consumers. Some states already have strong predatory lending laws -- New York, for example, has a law against prepayment penalties in mortgage contracts, and up until 2004, if you had such a penalty in a contract, it was void. But the federal government says that such laws can only apply to banks chartered in that state, so many banks have escaped such regulation today by being nationally chartered.

Where to find help

Got serious mortgage trouble? In addition to seeking the advice of a consumer-advocacy attorney, here are some places to look for help:

- At the Web site for Americans for Fairness in Lending you can plug in your ZIP code to find a financial counseling resource near you.
- In early April, the Neighborhood Assistance Corporation of America, an 18-year-old housing advocacy group, pledged $1 billion to refinance the loans of lower-income people who are at risk of losing their homes.
- The National Community Reinvestment Coalition has information on how to keep your home and has a Consumer Rescue Fund that works with victims of predatory lenders to make their mortgage payment more affordable.
- As the subprime lending crisis deepens, some lenders -- who in the past were somewhat willing to work with borrowers to keep them in their homes -- are becoming even more accommodating, to the point that "in a lot of

cases they're willing to modify the loan terms to keep people in their homes," says Blower. Call your lender when you realize you're having problems, he advises. For example, EMC Mortgage, a subsidiary of the Bear Stearns investment bank, which services a half-million loans across the U.S., has formed a 50-person, roving Mod Squad to make custom solutions for homeowners struggling to stay in their homes. Information: (877) 362-6631.