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A Brief Primer on Fighting Predatory Lending Practices

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There has been a great deal of coverage in the mainstream media in the past year regarding the increase in non-traditional lending practices, including the making of interest-only and negative amortization loans. The media often concludes its coverage with the optimistic observation that these creative lending practices have contributed to a greater percentage of homeowners in the United States.

Upon closer inspection, however, "nontraditional lending practices" in many instances becomes a euphemism for a disturbing rise in predatory lending practices to hopeful homebuyers. The rosy optimism and the image of proud homeownership cultivated by the media obscures a darker reality: growing in tandem with the rise in the number of home owning Americans are a range of practices collectively known as predatory lending practices, and a consequent rise in foreclosures throughout the nation.

Briefly, predatory lending is a term used to describe a variety of practices that mislead consumers, gouging them with exorbitant fees and usurious interest rates on their loans. In the context of home mortgage loans, predatory lending practices strip the equity from a home. In essence, practices which at first blush appear to enable home buying ultimately destroy the possibility of authentic ownership. Historically, more than 50% of the victims of predatory lending practices have been the elderly of all ethnic backgrounds, followed by African-Americans and Hispanics. The victim profile is changing, however; as predatory lending practices become more vicious, sophisticated, and prevalent, young, white prospective homeowners are as at risk as populations that historically may have been more vulnerable to them.

Predatory lending in the context of home buying is comprised of a plethora of lending practicing and arrangements, including:

- Kickbacks to mortgage brokers (Yield Spread Premiums, where a broker can get a loan at a lower interest rate, but tells the borrowers only about the higher rate loan so that the broker will receive a kickback from the lender);
- A lender's arrangements for payments that are higher than the borrower can afford;
- Falsifying loan applications (i.e., a lender may state on a loan application that a prospective borrower's income is greater than it really is in order to facilitate approval of the loan);
- Adding insincere co-signers (lender adds a fake cosigner for loan approval);
- Making loans to mentally incapacitated homeowners;
- Forging signatures (lender forges a borrower's signature on an early disclosure);
- Paying off lower income or interest mortgages;
- Loans in excess of 100% loan to value (LTV);
- Bait and switch tactics, such as substantially changing loan terms at closing;
- High annual interest rates;
- High points or padded closing costs;
- High loan origination fees;
- Balloon payments;
- Negative amortization (where principal balance increases rather than decreases);
- Padded appraisal costs (inflated home values in appraisal);
- Padded recording fees;
- Bogus fees (e.g., HUD will state that the broker has a fee for underwriting fee, when in fact brokers have no underwriting fee);
- Itemizing duplicate services and charging separately for them;
- Misinforming the prospective homebuyer that credit insurance is required and/or failing to disclose to the buyer that they are earning a commission on the insurance;
- Mandatory arbitration clauses;
- Falsely identifying loans as lines of credit or open ended mortgages;
- Forced placed homeowners insurance (lender falsely claims that homeowner does not have insurance and then gets an undisclosed commission for selling it to them);
- Repeated refinancing (flipping);
- Daily interest when payments are late;
- Excessive prepayment penalties;
- Foreclosure abuses; and
- Home improvement scams.

A range of state and federal law of laws are available to help attorneys address dismantle the harm wrought by predatory lending practices. Federal legislation that can protect homeowners includes the Truth in Lending Act (TILA), 15 U.S.C. § 1601 and the Real Estate Settlement Practices Act (RESPA), 12 U.S.C. § 1201. Regulations Z and X, derived from the federal statutes, and the Commentary to the Regulations also benefit consumers in suits against predatory lenders. State consumer protection act statutes and traditional common law causes of action, including fraud, negligence, unjust enrichment, intentional infliction of emotional distress, and unconscionability, also may enable consumers to prevail in claims against predatory lenders.

Not coincidentally, the prevalence of predatory lending practices and the subsequent increase in foreclosure rates has contributed to an increase in foreclosure rescue scams. Foreclosure rescue scams describe an ever-evolving range of scams whereby a third party approaches a homeowner who has fallen behind on his mortgage payments, offering to help the homeowner forestall an impending foreclosure. In the simplest version, a fly-by-night company offers to negotiate with the borrower's lender to arrive at some sort of workout, thereby stopping the foreclosure. More often than not, the company has no physical presence and operates from a mailbox rental address and/or a website. The company generally charges a homeowner between $1,500 and $2,500 for its services and demands payment up front. After receiving its fee, the company vanishes, its promises to negotiate a workout unfulfilled. The funds the desperate homeowner paid the company are now unavailable to either help reinstate the homeowner's loan, or to help him relocate should a workout with the lender not be possible.

In a more pernicious foreclosure rescue scam, the savior company approaches the homeowner and offers to help save his home by temporarily "buying" it from the homeowner. In this version of the scam, the company persuades the homeowner to sell the home to either the company or to an "investor" (a third party involved in the scam). The company or investor then permits the homeowner to continue living in the home, renting it from them with an agreement that the homeowner can earn back title to the home. More often than not, the repurchase price is substantially higher than the price the homeowner originally paid for the home. Even in cases where the repurchase price is not higher than the original purchase price of the home, the rent is equal to or greater than the amount of the homeowner's prior mortgage payments. Barring a highly improbable, fortuitous change in circumstances for the homeowner (how many of us win the lottery?), the transaction is destined to fail: a homeowner who is unable to meet mortgage payments will not be able to meet rent payments that are equal to or higher than those mortgage payments. Typically, the company evicts the homeowner within six months of the rescue sale, and the homeowner loses any equity he may have had in his home prior to the scam.

In addition to fraud, negligence, consumer protection act claims, unconscionability, unjust enrichment, slander of title, and intentional infliction of emotional distress, foreclosure scam artists may be liable under state statutes addressing the licensing of mortgage brokers and real estate sales and under federal lending statutes.

There are several resources available to attorneys who wish to pursue predatory lending and foreclosure rescue scam cases Many states have active consumer law bars that may also offer assistance and advice. The most thorough print resources are a series of volumes on consumer law published by the National Consumer Law Center (NCLC) (www.consumerlaw.org). One volume is dedicated to a detailed analysis of TILA, while other volumes address foreclosure law and consumer banking law. All of NCLC's volumes include sample pleadings, interrogatories, and other useful documents in appendices. The National Association of Consumer Advocates (NACA) (www.naca.net) also is an invaluable resource for attorneys contemplating developing a practice assisting homeowners with predatory lending and its attendant issues.

Melissa A. Huelsman is an attorney practicing in Seattle. Her practice is focused on predatory lending, consumer and fraud litigation, and bankruptcy. Ms. Huelsman received her J.D. from Southwestern University School of Law, Los Angeles, California. She is admitted to practice before the State Bars of California and Washington, the Ninth Circuit Court of Appeals, the United States District Court for the Central District of California and the United States District Court for the Western District of Washington and for the Eastern District of Washington. In addition to pro bono work, Ms. Huelsman is a member of the Board of the King County Bar Bulletin, and former Chairperson of the P.L.A.C.E. Subcommittee of the Seattle-King County Coalition for Responsible Lending. Ms. Huelsman is also an associate member of the Association of Certified Fraud Examiners and a member of the National Association of Consumer Advocates.