

**PREDATORY MORTGAGE LENDING
AND THE S.C. HIGH COST AND CONSUMER HOME LOAN ACT**

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South Carolina High Cost and Consumer Home Loan Act

37-23-20: This is the definition section of the new law. It defines a number of terms including but not limited to: (a) consumer and high cost loans; (b) how to determine what fees and points are used to calculate the fees threshold for a high cost loan as well as what fees and points do not go into this calculation; (c) conventional mortgage rate; (d) conventional conforming discount points; (e) conventional prepayment penalties; and (f) flipping.

This section provides the road map to how to determine whether or not a loan should fall under the High Cost Home Loan sections of the law. If the loan is determined to be a high cost home loan the lender special protections apply.

37-23-30: This section limits a number of practices for High Cost Home Loans. These prohibited practices include: (a) balloon payments (b) call provisions (c) negative amortization (d) additional charges to modify or extend the loan and (e) the prohibition of a choice of law provision.

37-23-40: This section prohibits and mandates certain practices that include: (a) sending the borrower for mandatory consumer counseling on the advisability of the loan; (b) only make loans that have a payment, along with other monthly debts, that does not exceed 50% of the borrower's income; (c) prohibits the direct or indirect financing of more than 2.5% of fees and points; (d) prohibits charging the borrower any fees and points if the loan is a refinance with the same lender; and (e) if it is a home improvement loan, the lender must make the check out to both the contractor and the borrower or to a third-party escrow agent.

37-23-45: A Mortgage Broker must provide a full disclosure of all fees earned from both the borrower and the lender.

37-23-50: This is the damage's section of the law. If the law is violated, the borrower may sue for a statutory penalty of not less than \$1,500.00 and not more than \$7,500.00, plus costs and attorney's fees. In addition the court may modify the contract to take out all offending terms.

37-23-60: Safe Harbor provision for bona fide errors that the lender can and will correct under certain circumstances.

37-23-70: The Consumer Home Loan Act. This section applies to all mortgages whether or not they are high cost. This section prohibits:

(A) The Flipping of Loans. A loan is flipped if it is made within 42 months of the last mortgage loan and the borrower did not receive a net tangible benefit. There is a presumption of benefit if the interest rate was lowered substantially, the borrower's total debts do not exceed 50% of his income, the borrower received a substantial amount of cash compared to the fees, the duration of the loan was changed. It is presumed a flip if the loan was a special low rate loan as with a Habitat for Humanity loan. **37-23-20(8)**

(B) Financing Single Premium Credit and Debt Cancellation Insurance. Beginning January 1, 2005, a lender may no longer directly or indirectly finance these insurance products.

(C) A lender may not encourage default while making a loan.

(D) Requires disclosures by a Mortgage Broker of where a borrower may make a complaint.

(E) Prohibits choice of law provisions in the loan documents.

(F) Damages provision. If the law is violated, the borrower may sue for a statutory penalty of not less than \$1,500.00 and not more than \$7,500.00, plus costs and attorney's fees. In addition the court may modify the contract to take out all offending terms.

37-23-75: A Mortgage Broker must provide a full disclosure of all fees earned from both the borrower and the lender.

37-23-80: Prohibits prepayment penalties for loans less than \$150,000. This is also addressed in **37-10-103**. In addition, this amount will increase every two years with inflation and is tied to the Consumer Price Index, **37-1-109**.

37-23-85: This is the safe harbor provision for good faith bona fide errors of the Consumer Home Loan Act.

37-2-309 and 37-3-308: This section requires RESPA like disclosures for consumer mobile home loans. If any material term is to change then the loan cannot be closed until one day after the redisclosure. If violated the lender may be subject to a statutory penalty of up to \$1,000.00, plus attorney's fees.

37-5-108: Changes the definition for the term unconscionability from a subjective to an objective standard. A lender must look at a borrower's ability to repay the loan based on underwriting criteria. If the lender does not do this and the borrower is unable to pay, the loan may be found to be unconscionable under the law. Prior to this change, the lender only had show he believed that the borrower could repay without any demonstration of how he formed this belief.

37-3-413: Short term Vehicle Loans. This new section of the Consumer Protection Code was enacted to address the abuse of Auto Title Lending. These lenders make very short term loans using only automobiles as collateral. These loans are typically 30 days, with an interest rate of approximately 300% APR. The lender makes the loan knowing that the consumer cannot make the full payment at the end of the 30 days. The consumer will often pay back just the interest and still owe the entire principal. This means on a \$600.00 loan the interest that accrues in 30 days is \$150.00.

Under the new law, the lender may only flip this loan six times for no more than 240 days. At the end of the sixth flip, the loan freezes and the consumer has 180 days to pay the remaining balance before the lender may attempt to repossess the car.

40-58-78: This section amends the Mortgage Broker's licencing law. A Mortgage Broker or Originator will now be the agent of the borrower and owe the borrower a duty of utmost care, loyalty and honesty when representing him in a transaction. If the Mortgage Broker violates this section, he will be liable for a penalty between \$1,500.00 and \$7,500, plus attorney's fees. In addition, the Broker could be forced to return his fee.

34-4-14: Prohibits local ordinances that would attempt to regulate credit.

The effective date of the Act is January 1, 2004, except where noted above as to the financing Credit Insurance. That section goes into effect January 1, 2005.

Prime, Subprime and Predatory Loans

Today's housing market is divided into two parts: prime and subprime. Prime mortgages are offered to people with excellent credit and employment histories and sufficient income to cover their debts. Subprime loans are often offered to borrowers with credit blemishes, poor employment histories, and high debt to income. Subprime loans generally do not meet Fannie Mae and Freddie Mac standard underwriting criteria and are priced higher to cover risk.

Predatory loans are a subset of subprime loans. Though most subprime loans are not predatory, almost all predatory loans are subprime. While other loans are designed to build family wealth, predatory loans include loan terms that strip home equity and trap borrowers in high cost loans.. Too often, families lose the home they owed outright just a few years earlier.

There has been dramatic growth in subprime lending in recent years. According to a recent HUD study, between 1993 and 1998:

-) Subprime refinancing loans increased 10 fold
-) Subprime new purchase loans increased 14 fold
-) Subprime as a share of the total mortgage market increased form \$20 billion to \$150 billion.

Eighty percent (80%) of subprime loans are refinances and, in turn, most predatory loans are refinances as well.

Predatory Lenders Target Seniors and African-Americans

Seniors are often rich and cash poor. Over half the seniors in this country with incomes of less

than \$10,000 own their house outright. The average age of a person owning their home is 65, and the total home equity held by seniors is \$1 trillion. This home equity is a huge target for predatory lenders, who find the elderly particularly easy to talk into a bad loan.

Similarly, African-Americans are prime targets for predatory loans. For generations, African-Americans have been denied access to credit. Now, predatory lenders are taking advantage of this history of denial. They target African-American families with expensive loans, counting on their taking the loan with little or no comparison shopping. Of the wealth that African-Americans own, 63% is in home equity. This wealth is increasingly being stripped through discriminatory racial targeting. Subprime loans are:

-) 3 times more likely in low income neighborhoods
-) 5 times more likely in African-American neighborhoods, and
-) 2 times more likely in high income African-American neighborhoods than in low income White neighborhoods

Common Predatory Lending Practices

The following are some of the more common predatory lending practices. After each section is a summary of South Carolina laws that address these abuse. The new South Carolina Law addresses both high cost loans and consumer home loans.

1. Financing Excessive Fees into Loans

Predatory lenders often finance huge fees into loans, stripping thousands of dollars in hard-earned equity and racking up ideational interest in the future. Borrowers in predatory loans are charged fees of up to 8 to 10% of the loan amount, compared to the average 1 to 2% fees assessed by banks to originate loans. Once the paperwork is signed and the rescission period expires, there is no way to get that equity back, and borrowers frequently lose up to \$10,000 or \$15,000 in home equity while receiving little, if any, benefit from the refinancing. The damage is compounded at higher interest rates as borrowers often pay tremendous interest costs in the years it takes just to pay down the fees. Since the early 90's, lenders typically have kept loan fees below 8% in order to stay under the federal Home Ownership Equity Protection Act (HOEPA) fee threshold, which would then require additional disclosures to the borrowers and additional consumer protections.

A couple with limited English speaking skills were convinced to refinance their mortgage and take a cash out of around \$9,500. To do so, they were charged \$10,368 in lender fees, plus another \$927 in third party fees, which totaled around 8% of their loan amount of \$145, 259. They are now struggling to make their monthly payments, which, unlike their previous loan, do not include taxes and insurance.

SC Law: The new High Cost Home Loan and Consumer Home Loan Act now makes all loans that have fees and points more than 5% of the amount borrowed a High Cost

Home loan, 37-23-20(15). The definition of what is included in the fees and point's threshold is provided in 37-23-20(13). A rule of thumb for fees and points is any bona fide third party (non-affiliate) fee paid during a loan closing is not included in the threshold.

Under 37-23-40(3), when a loan is deemed to be a high cost home loan the broker, lender or originator is limited as to the financing of these costs. If the refinancing of the loan is with an existing lender, the lender is prohibited from financing any fees and points. If it is the refinancing of a loan with a different lender than only 2.5% of the fees and points may be financed in the new loan.

2. Single Premium Credit Insurance

Credit insurance is insurance to pay off the home loan in the event of death (credit life insurance), sickness (credit health insurance), or losing your job (credit unemployment insurance). Financed "single premium" credit insurance is the single most significant predatory lending practice because it strips home equity. It is rarely promoted in the "A" lending world, but has been aggressively and deceptively sold with subprime loans, and then financed into the home loans costing borrowers equity in their homes, and forcing them to pay interest on the insurance premium for 30 years.

With "single premium" policies, instead of making regular monthly, quarterly, or annual payments as people do with other insurance policies, the credit insurance is paid in one lump sum payment, which may be as high or even higher than \$10,000. This premium is then financed into the loan, increasing the loan amount (and since the loan amount is higher, the lender's origination fees also increase), and the borrower must then pay monthly interest on the amount of the insurance premium. While the coverage on a single premium policy usually lasts for only 5 years, the borrower pays for it, and pays interest on it, over the 30 years of the home loan. Typically, single premium credit insurance policies cost four to five times as much as monthly-paid credit insurance and over ten times as much as term life insurance policies, and of course the cost of these alternative products are not staked against the borrower's home. If the borrower sells or refinances their home towards the end of their 5 to 7 year coverage period, almost the entire premium is included in the payoff amount and stripped from the equity in their home.

There is widespread agreement that financing single premium credit insurance into mortgage loans is abusive and illegitimate. Fannie Mae and Freddie Mac both refuse to purchase loans that include financed credit insurance. A recent HUD/Treasury report on predatory lending recommended that the financing of single premium credit insurance policies be banned on all home loans. The Federal Reserve Board has issued a proposed regulation that would count single premium credit insurance premiums as "points and fees" for the purposes of federal HOEPA. The Consumer Federation of America calls financed single premium credit insurance "the worst insurance rip-off in the country."

In recognition of the widespread opposition to this predatory product, and in response to massive pressure from community organizations and advocates, many large lenders, including Citigroup and Household Finance, have agreed to stop selling financed single premium credit insurance policies.

A homeowner refinanced into a 30-year, \$55,252 loan at a 13.85% interest rate with monthly payments of \$648-\$108 if which goes to pay for the credit insurance. Included in this loan amount was \$9,156 for credit life, credit accident, and credit unemployment insurance through an affiliate of the lender. Financing this amount into the loan will cost the homeowner over \$136,000 more than if he had used the entire \$648 to pay down the loan early.

A homeowner financed a \$10,000 single premium credit insurance premium as part of their 163% interest rate home loan. After 5 years, the borrower refinances their home. (This is an average timer for the term of the credit insurance coverage also an average time for refinancing.) Though the borrower has paid over \$8000 in total payments for their credit insurance, they have paid only \$104 toward principal. The remaining \$9896 (\$10,000 minus \$104) they owe is stripped from the equity in their home at the time of refinancing. They are not eligible for a rebate since they have "used up" their 5 year insurance coverage.

SC Law: Under the new South Carolina Law, 37-23-20(13)(e) Single Premium Credit Insurance and Debt Cancellation Insurance will be included as part of the fees and point's threshold when considering whether or not the Mortgage would be considered a High Cost Home Loan. This provision will sunset January 1, 2005.

Beginning January 1, 2005, it will be illegal to finance Single Premium Credit Insurance or Debt Cancellation Insurance, directly or indirectly, with any home mortgage. 37-23-70(B).

3. Prepayment Penalties

It is estimated that 80% of subprime loans contain prepayment penalties, as scampered to 2% of conventional loans. The penalties come due when a borrower pays off their loan early, typically through refinancing or a sale of the house.

Prepayment penalties trap borrowers in high interest rate loans, which too often lead to foreclosure. They are hidden, deferred fees that strip significant equity from over half the subprime borrowers. Prepayment penalties are often 5% of the outstanding balance due on the loan. For a \$150,000 loan, this fee is \$7,500, more than the total net wealth built up over a lifetime for the average African-American family. Other prepayment penalties are written as "6 months interest", which is roughly equivalent to 6 times the monthly payment, since most of the

payment is interest in the early years of the loan.

A particular damaging use of prepayment penalties is when they are combined with an adjustable rate loan. Borrowers are sold a loan with a starting rate which lasts for two or three years and which then rises dramatically. When, faced with the new higher interest rate, they look to refinance, they find that they will have to pay a prepayment penalty.

Borrowers are frequently unaware that their loans contain a prepayment penalty. Lenders' agents simply fail to point it out, or they are deliberately misleading, telling borrowers that they can refinance to a lower rate later, while neglecting to inform them of the prepayment penalty which will be charged if they do so. Many borrowers are misled in this way even when they have been presented with the legally required disclosure. This and other crucial documents are easy to miss in the mounds of paperwork involved in closing a loan.

A couple wanted to lower the monthly payment of their two mortgages and were looking to refinance. A loan officer told them he could save them \$200 to \$300 a month, and they went ahead with the refinance. They ended up with two mortgages, a first for \$133,000 at 10.5% interest and a second for \$10,000 at 21.7%. This gave them a total monthly payment of \$1,501-\$125 more than before. Their new first mortgage also included almost \$10,000 in fees. They had very good credit and when they looked into refinancing in order to receive a better interest rate, they found out that both of their loans had prepayment penalties which required that if they refinanced within the first five years of the loan, they would have to pay a penalty of six months interest - more than \$7,000. Despite their good credit, they are now stuck in these high interest rates. Mainstream lenders will not refinance them, because their loan amounts and the prepayment penalties, their new loan would have to be for more than their house is worth.

South Carolina Law: Unlike many states, South Carolina has always prohibited the charging of a prepayment penalty for any mortgage loans that are less than \$100,000. 37-5-102. This law has been modified under the new Act. First, the new Act will prohibit prepayment penalties for home mortgages only. It also increases the prohibition for prepayment penalties for loans less than \$150,000. 37-5-103 and 37-23-80. It also allows for the statute to increase this ceiling every two years based on inflation using the Consumer Price Index. 37-1-109(6). The South Carolina Department of Consumer Affairs through the promulgation of regulations will issue the new rate.

Note: If a loan does contain a prepayment penalty, for example one more than \$150,000, the amount of the potential penalty must be included in the fees and point's threshold. This means that if a prepayment penalty can be charged upon a future refinancing, there is a good chance it will make the loan high cost.

4. Mortgage Brokers Abuses Including Yield Spread Premiums

Mortgage brokers originate approximately seventy percent of all mortgage loans, and a relatively small number of brokers are responsible for a large percentage of predatory loans. A common problem with predatory loans is steering borrowers into high interest rate loans, and trapping them in these loans with prepayment penalties. Some brokers receive a cash bonus, called a yield spread premium, for placing borrowers in a loan with a higher interest rate than the lender would have given the borrower at their standard or “par” rate. Yield spread premiums create an obvious incentive for brokers to make loans with the highest interest rates and fees possible, regardless of whether the borrower could qualify for better terms. The broker is paid an even higher bonus if they lock the borrower in with a prepayment penalty. Some brokers also charge exorbitant up-front fees, unjustified by their services provided.

A homeowner with good credit received a \$57,600 loan through a mortgage broker. On the loan, which had a fixed interest rate of 9.75% for two years and then became adjustable, the broker charged the borrower a 6% origination fee, and then the lender charged the borrower another \$850 for processing fees. In addition, the lender paid the broker a yield spread premium of \$1,152-2% of the loan amount - for getting the homeowner to accept this loan.

South Carolina Law: The Mortgage Broker now has a new duty, acting as an agent for the borrower, owing her a duty of utmost care, loyalty and honesty. 40-58-78. Violating this duty can result in a statutory penalty between \$1,500.00-\$7,500.00, the return of the mortgage broker’s fees, plus attorney’s fees and costs.

Mortgage Brokers and Originators are now required to provide the borrower with a separate disclosure detailing all compensation that he or she will earn from the transaction, including the Yield Spread Premium, 37-23-45 and 37-23-75. In addition pursuant 37-23-70(D) and 37-23-45 a Mortgage Broker must provide the borrower information about where she may file a complaint concerning the Broker or Loan.

5. Steering Borrowers Into High Cost Loans

Though higher interest rates are intended to compensate lenders for taking a greater credit risk, too many borrowers are being charged rates and fees that cannot be justified based on the borrower’s credit profile. Borrowers with perfect credit are regularly charged interest rates 3 to 6 points higher than the market rates; with some subprime lenders, there simply is no lower rate, no matter how good the credit. According to recent rate sheets used by some subprime lenders, their lowest interest rate for a borrower with excellent credit and a low loan-to-value ratio was a 10% to 11%. And for borrowers with imperfect credit, rates are frequently much higher than blemished credit would reasonably warrant, as well as for what the industry describes as standard rates for B, C, or D borrowers. This is particularly troubling for lenders with prime affiliates -

the very same “A” borrower who would receive the lender’s lower rate from its prime affiliate pays substantially more from the subprime affiliate, for “walking the wrong door”. This steering has a racial impact since borrowers in African-American neighborhoods are five times more likely to be in a subprime loan. Minority borrowers should not have to pay more for the same loan.

A husband and wife with FICO scores of 721 and 693, respectively (they had even higher ratings from other credit bureaus), were not looking to refinance, but they were distracted by the recent death of a granddaughter and the loan officer made a strong sales pitch. Over \$14,000 in fees and a \$5,271 single premium credit insurance policy were financed into their loan, which they are locked into by a five-year prepayment penalty for over \$10,000. Despite their excellent credit record, they were given an interest rate of 13.0% on their mortgage.

South Carolina Law: The new South Carolina law addresses the steering of borrowers who are prime credit candidates into high cost mortgages. If the terms of a mortgage make it high cost under the law, the borrowers must be sent to a certified housing counselor to review the loan terms and circumstances. Under this section of the new law 37-23- the counselor is required to counsel the borrower as to the “advisability” of the loan. This includes the borrowers ability to make the monthly payments, the soundness of the fees and charges and the interest rate. The Department of Consumer Affairs has developed a check list for the counselor. A section on the check list includes a review of the borrowers credit report and credit score. A counselor will be in a position to advise a borrower if his or her credit score should allow the borrower to qualify for a prime or better interest rate.

6. Mandatory Arbitration Clauses

Borrowers should avoid mandatory arbitration clauses on all home loans. Increasingly, lenders are placing pre-dispute, mandatory binding arbitration clauses in their loan contracts. By signing these clauses, borrowers give up their right to sue. These clauses insulate predatory practices from effective legal review, relegating borrowers to a forum that is typically stacked against them. Lawyers are unable to obtain injunctive relief, file class action suits, obtain “discovery”, or go after punitive damages. Arbitration can involve costly fees, be required to take place in other states, and designate a pro-lender arbitrator. Arbitration can also take valuable time the borrower does not have if they are facing foreclosure. These clauses are unfair to borrowers who typically do not understand the rights they are giving up when they sign the agreement.

SC Law: The new law does not address mandatory arbitration clauses, thus consumers will have to rely on existing South Carolina and Federal law for this issue. Unfortunately, these are difficult clauses to get around and must be looked at on a case by case basis.

7. Loan Flipping

Flipping is a practice in which a lender, often through high-pressure or deceptive sales tactics, encourages repeated refinancing by existing customers and tacks on thousands of dollars in additional fees each time. Some lenders will intentionally start borrowers with a loan at a higher interest rate, so that the lender can then refinance the loan to a slightly lower rate and charge additional fees to the borrower. This kind of multiple refinancing is never beneficial to the borrower and results in the further loss of equity. Flipping can also take place when competing lenders refinance the same borrowers repeatedly, promising benefits each time which are not delivered or which are outweighed by the additional cost of the loan.

One of the most egregious forms of flipping is the refinancing of 0% interest rate loans, such as those given to Habitat for Humanity borrowers, or forgivable or subsidized low interest rate loans designed to get low to moderate income borrowers into a home.

A lender convinced an elderly couple to refinance their mortgage to a new loan amount of around \$93,000, which included over \$10,000 in financed fees and a single premium credit life insurance policy for close to \$6,000. Two years later, the same lender convinced the couple to refinance again (without paying off any other debts) a fixed interest rate of 11.5% financing into their loan what looks like over \$2,200 in fees plus a credit insurance policy for over \$10,000. Another year later, the same lender refinanced them again at an 11.5% interest rate without any discernible benefit while they were charged another nearly \$900 in additional fees.

South Carolina Law: A loan is flipped if it is made within 42 months of the last mortgage loan and the borrower did not receive a net tangible benefit. There is a presumption of benefit if the interest rate was lowered substantially, the borrowers total debts do not exceed 50% of his income, the borrower received a substantial amount of cash compared to the fees, the duration of the loan was changed. It is presumed a flip if the loan was a special low rate loan as with a Habitat for Humanity loan. 37-23-20(8).

8. Making Loans Without Regard to the Borrower's Ability to Pay

Some predatory lenders make loans based solely on a homeowners' equity, even when it is obvious that the homeowner will not be able to afford their payment. For mortgage brokers, the motivation to engage in these kind of practice is a short-sighted desire for the fees generated by the loan. Loan officers at mortgage companies may have similar motivations based on earning commissions, regardless of the consequence to the lender for which they work. For some lenders, especially when there is significant equity in a home, the motivation is the ultimate foreclosure on the house which can then be resold for a profit.

A mortgage lender solicited a homeowner for a second mortgage to consolidate his debt. The new loan had a 13.4% interest and a monthly payment of \$612, leaving him with a

total housing payment of \$1,257 a month. At the time that he received the loan, he was working at a plastic company and had gross earnings of \$1,600 a month, meaning that his housing payment was 79% of his income. As would be expected, he has fallen behind on both of his payment and is facing foreclosure.

South Carolina Law: 37-23-40 requires that a lender who makes a high cost loan should only make loans that have a payment, along with other monthly debts, that does not exceed 50% of the borrowers income.

9. Loans for Over 100% Loan to Value

Some lenders regularly make loans for considerably more than a borrower's home is worth with the specific intents of maximizing their debt and thus their payments, and trapping them as customers for an extended period. Even borrowers with excellent credit have no way to escape from a high rate loan if they are 'upside down' and owe more than their home is worth. Borrowers are frequently unaware that they owe much more than their homes are worth, and even more frequently unaware of the consequences.

A single mother bought a house for her three kids and soon started receiving solicitations to refinance her debts from a lender. When she eventually agreed to do so, her loan amount was inflated to \$156,000 - compared to the house's value of \$145,000 - by well over \$12,000 in financed fees and a financed single premium credit life insurance policy for \$3,491. Her interest rate jumped to 12.2% and she was locked into the high rate with a five-year prepayment penalty of nearly \$10,000, which she was never told about. Now she is prevented from refinancing out of her high interest rate of 12.2% - compared to the variable interest rate of around 7% on her previous first mortgage - because her loan is for more than her house is worth, plus she has a five year prepayment penalty for nearly \$10,000.

There is not specific provision addressing this issue in the new South Carolina Law, but if it is a refinance this practice could violate 37-23-70(A) prohibitions on Flipping.

10. Home Improvement

Some home improvement contractors deliberately target their marketing efforts to lower income neighborhoods where homes are in most need of repairs, and where the owners are unable to pay for the service. The contractor tells the homeowner that they will arrange for the financing to pay for the work and refers the homeowner to a specific broker or lender, even driving them to the lender's or broker's office. Sometimes the contractor begins the work before the loan is closed, so that even if the homeowner has second thoughts about taking the loan, they are forced into it in order to pay for the work. The lender may then make the payments directly to the contractor, which means that the homeowner has no control over the quality of the work. As a result, the work may not be done properly or even at all, but the homeowner is still stuck with a high-interest, high fee loan.

Allowing for the loan proceeds to go directly to the contractor for work that has not been completed often also lead to problems for those homeowners who seek out contractors rather than being solicited by them.

A couple received a phone call from a construction company asking if they needed any work done on their house. The couple did need some home repairs, but they didn't have the money to pay for it. The man from the construction company told them that he could arrange for them to get the financing not only to pay for the repairs, but also to pay off other bills. He picked them up and drove them to fill out a loan application with a loan officer he knew at a local lender. The contractor began the work, but as soon as the check was ready from the lender, he went to pick it up and never came back to finish the work. But the couple still has to pay the loan back at 12.9% interest.

A homeowner was contracted by a lender about refinancing. She consolidated \$3,000 in unsecured debt with the \$28,000 that she still owed on the house, and on her home. She requested that she be allowed to choose her own contractor, but the lender said she had to use a specific contractor or they would not loan her the money. The lender paid the \$6,000 directly to the contractor, but no work has been done to her house because the contractor filed for bankruptcy. She is now stuck paying back the loan at 13% interest. She was also charged \$3,426 in fees and closing costs which were rolled into the \$34,000 loan.

South Carolina Law: 37-23-40 requires that if the high cost loan is a home improvement loan, the lender must make the check out to both the contractor and the borrower or to a third-party escrow agent.

11. Balloon Payments

Mortgages with balloon payments are arranged so that after making certain number of regular payment (often five or seven years worth, sometimes 15), the borrower must pay off the remaining loan balance in its entirety, in one "balloon payment." About ten percent of subprime loans have balloon payments. Predatory lenders use balloons to sell the borrower on the low payment, without making it clear that this payment does not cover the principal owed.

There are specific circumstances where balloon payments make sense for some borrowers in loans at "A" rates, but for most borrowers in subprime loans they are extremely harmful. Balloon mortgages, especially when combined with high interest rates, make it more difficult for borrowers to build equity in their home.

After paying for some number of years on the loan, with the bulk of the payments going, as they do in the early years of a loan, to the interest, homeowners with balloon mortgages are forced to refinance in order to make the balloon payment. They incur the additional costs of points and

fees on a new loans, and they must start all over again paying mostly interest on a new loan, with another extended period, usually thirty years, until their home is paid for.

In addition, many borrowers are unaware that their loan has a balloon payment, that their monthly payments are essentially only paying interest and not reducing their principal, and that the balloon will ultimately force them to refinance.

A couple refinanced in 1998 and received an \$89,250 loan at 9.95% interest from a lender. After fifteen years of paying \$780 a month for a total of \$138,400 they will owe a balloon payment of \$73,564. In addition, the loan had a prepayment penalty if they try to refinance out of the loan during the first three years.

South Carolina Law: 37-23-30 prohibits all balloon payments for High Cost Home Loans.

12. Negative Amortization

In a negatively amortized loan, the borrower's payment does not cover all of the interest due, much less any principal. The result is that despite regularly making the required monthly payment, the borrower's loan balance increases every month and they lose, rather than build, equity. Many borrowers are not aware that they have a negative amortization loan and don't find out until they call the lender to inquire why their loan balance keeps going up. Predatory lenders use negative amortization to sell the borrower on the low payment, without making it clear that this payment will cause the principal to rise rather than fall.

A homeowner with good credit received a \$64,000 loan through a mortgage broker. The broker told her the loan would have an interest rate of 5.5% and a monthly payment of \$363. However, she was not told that this was only a "teaser rate" and that the interest rate would increase and soon rise to 8.4%. Her monthly payment of \$363, which was based on the "teaser" interest rate, remained the same even after the interest rate increased, and so did not cover all of the interest due. Thus, even when she makes her full payment, her principal amount increases. The homeowner was unaware that her loan contained these terms.

South Carolina Law: 37-23-30 prohibits negative amortization for all High Cost Home Loans.

13. Property Flipping

Property flipping is an elaborate scam in which unsuspecting first-time home buyers are sold houses in serious states of disrepair for prices far above what the houses are actually worth.

The typical "property flip" begins with an investor or real estate company purchasing a distressed property for as little as a couple of thousand dollars. After doing minimal cosmetic or

even no work to the property, the owner finds a buyer, frequently targeting low-income, minority families. The buyers have no agent representation of their own and no real estate knowledge, putting them at the mercy of the seller/owner. The seller/owner abuses this position by lying about the condition of the house, promising to make visibly-needed repairs, setting the sales price at far above the property's actual value, and referring the buyer to a subprime lender or broker.

Many subprime lenders will only make a purchase loan if the loan is for 80% or less of the value of the property. In these instances, the property seller uses a number of schemes in order for it to appear that the buyer has the required payment of 20% or more. The seller first sets the sales price far above what the property is actually worth, then the seller falsifies the buyer's deposit and will often create a second mortgage, which exists on paper only. The key to the scam is having a lender or broker that will utilize appraisers who will support the property's inflated sales price. In exchange for their participation, the lender or broker is compensated by the fees and additional charges on the loan, which are often excessive.

Buying one's first house is often a major milestone in life and an important step towards achieving economic self-sufficiency, but the swindlers involved in property flipping have made the experience one of the worst things to ever happen to their victims. While there are no hard numbers about how many families have been victimized by property flipping, the problem reached epidemic proportions in many cities before the authorities were even aware that a problem existed.

A first-time home buyer was sold a house for \$75,000. The seller referred the buyer to a mortgage broker which arranged for the buyer to receive a \$60,000 loan (80% of the purchase price) from a lender at 10.65% interest. In order for the buyer to show a 20% down payment, the seller made it seem as if the buyer had put down a \$7,500 deposit and that the seller was providing a \$7,500 second mortgage. The seller paid all the buyer's closing costs, \$3,900, to the broker and lender. In addition, the broker received an \$1,800 yield spread premium from the lender. The seller walked away with a profit of \$54,799.

South Carolina Law: This practice could violate the Unfair and Deceptive Practices Act, and criminal fraud laws. In addition for High Cost Mortgages it could violate the 37-23-40 which requires that the loan payment not exceed more than 50% of the borrowers monthly income.

14. Aggressive and Deceptive Marketing

Much of the competition between lenders in the subprime industry is not based on the rates or terms offered by the different lenders, but on which lender can reach and "hook" the borrower first. Predatory lenders employ a sophisticated combination of "high tech" and "high touch" methods, using multiples lists and detailed research to identify particularly susceptible borrowers

(minority, low-income, and elderly homeowner) and then mailing, phoning, and even visiting the potential borrowers in their homes to encourage them to take out a loan.

One of the methods used routinely and successfully by predatory lenders is the practice of sending “live checks” in the mail to target homeowners. The checks are usually for several thousand dollars and the cashing of depositing of the check means the borrower is entering into a loan agreement with the lender. The appeal of the check is that are a fast and easy way for a homeowner to obtain cash.

This initial loan is just an entry point into the financial life of the homeowner. The loan has an artificially high interest rate and monthly payment, in order for the predatory lender to be able to offer the homeowner an opportunity to refinance it, along with other debts, into another loan. The predatory lender’s ultimate goal is to get the homeowner to refinance their first mortgage with them.

A couple received a check in the mail for \$4,000. It came at a time when they needed money and so they decided to deposit it. The check was a loan with a 21% interest rate and a 5 year repayment term. Almost immediately after depositing the check, the lender called the homeowner and offered to refinance that loan at a lower rate and give them additional money. The new, larger loan was a 19% interest rate with a ten year repayment term which lowered the monthly payments. Shortly after this, the lender again contacted the homeowner and encouraged them to refinance again and to consolidate other debts. This loan was at 17% interest rate and had a repayment term of twenty years. The lender went back to the homeowner and encouraged them to refinance this loan along with their first mortgage which was with another lender. Their loan had a 12% interest rate and a thirty year repayment term.

South Carolina Law: The Law does not specifically address the live check, but this could ultimately violate a number of the provisions of the Act.

15. Predatory Servicing

Increasingly, borrowers are faced with problems associated with predatory servicing. Examples include:

-) Incorrect late fees, due to slow or inaccurate processing of payments
-) Not posting checks in a timely manner
-) Inaccurate or incomplete payment history records
-) Not responding to requests for payoff quotes, payment histories in a timely manner
-) Harassing collections
-) Aggressive foreclosures, and
-) Deceptive default and foreclosure claims.

Dealing with a problem servicer can be like dealing with the IRS, with borrowers often unable to

effectively advocated for their rights.