

A CLOSER LOOK

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A Closer Look takes topics from previous and current issues of *Bridges* and examines them from a local perspective.

...AT THE MEMPHIS REGION

A New Day in Tennessee

Law Takes on Abusive Mortgage Practices

Predatory lending: No matter how you define it, consumers and communities suffer. Shelby County, Tennessee is no exception—it's seen its share of abusive lending practices. However, a coalition of concerned citizens there decided they were going to do something about it.

The Memphis and Shelby County Anti-Predatory Lending Coalition consists of businesses, agencies and non-profits working together to develop public policy and educational initiatives to combat predatory lending. While many communities have worked toward the same goals, the coalition went one step further. It joined with other organizations across the state to work for a legal remedy.

The result was the Tennessee Home Loan Protection Act of 2006, which will go into effect Jan. 1, 2007.

What Is Predatory Lending?

Most organizations and agencies agree on some common features of predatory lending.

The Mortgage Bankers Association defines predatory lending as intentionally placing consumers in loan products with significantly worse terms or higher costs than loans offered to similarly qualified consumers in the region

for the primary purpose of enriching the originator and with little or no regard for the costs to the consumer.

A Fannie Mae Foundation report notes that predatory loans are characterized by excessively high interest rates or fees; abusive or unnecessary provisions that do not benefit the borrower, including balloon payments or single-premium credit life insurance and large prepayment penalties; and underwriting that ignores a borrower's repayment ability.

The Center for Responsible Lending pinpoints three common components: fee-based equity stripping, risk-rate disparity and excessive foreclosure rates.

Protections Under the New Law

Tennessee's new predatory lending law is modeled after a North Carolina law adopted in 1999 and applies only to high-cost loans. The new law will expand the definition of a high-cost loan. Mortgage loans normally have about 1 percent or 2 percent in fees. Predatory mortgages can have as much as 10 percent in fees. The new law sets a high-cost loan trigger so that any mortgage with more than 5 percent in fees will be flagged, and the lender will have to follow tougher rules regarding the loan terms.

Some new protections that will be in place for borrowers with high-cost loans focus on:

Flipping: Lenders may not refinance a mortgage loan within 30 months of an existing loan when the new loan does not offer a reasonable benefit to the borrower.

Prepayment penalties: Prepayment penalties in excess of 2 percent of the loan amount or imposed after a 24-month period from the making of a loan may not be included in high-cost loan terms or charged to a borrower in a high-cost loan. No prepayment fees may be charged in a new loan if a lender is refinancing a loan it holds or one that is held by an affiliate of the lender.

Financing points and fees: A lender may not finance points and fees in connection with a high-cost loan when the points and fees are more than 3 percent of the loan amount for loans of \$30,000 or more or 5 percent of the loan amount for loans of less than \$30,000. A lender may not charge a borrower points and fees in connection with a new loan if it refinances a loan held by the lender or an affiliate.

Lending without regard to the borrower's ability to repay: A lender may not make a high-cost home loan unless it reasonably believes

the borrower will be able to make the scheduled payments. Mortgage payments that are less than 50 percent of a borrower's income are presumed affordable.

Balloon payments: A lender may not make a high-cost home loan that contains a scheduled payment (otherwise known as a balloon payment) that is more than twice as large as a regularly scheduled payment.

Negative amortization: A lender may not make a high-cost loan in which the principal increases over the course of the loan, which results in negative amortization.

Other features of the new law prohibit a lender from making a high-cost loan and then calling the balance of the indebtedness due, absent a material default in repayment of the loan.

Severe restrictions have also been placed on a lender's ability to charge late fees in a high-cost loan. Lenders may not make high-cost loans in which the interest rate increases after a default. Lenders may not encourage or recommend defaulting on a high-cost loan. Lenders or servicers must provide borrowers with two payoff statements free of charge within any 12-month period.

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On a Personal Level: Two Case Studies

Predatory lenders most frequently target women, minorities and the elderly, according to the Center for Responsible Lending. Here are some real-life stories about people who became victims of predatory lending in Tennessee:

► A female employee of a local church inherited a family property with a mortgage that had all but \$554 paid off. She needed to make some repairs and also wanted an addition to the house, and so contacted a local home improvement contractor. The contractor looked at the woman's house, prepared a contract and then referred her to a mortgage company for financing. She signed a contract with the home improvement contractor, but did not receive a copy. The owner of the mortgage company convinced her to sign a blank contract for financing that he later completed and signed, omitting much of the work that she wanted done to the house.

The contract price was \$30,000, but she consummated a loan for \$40,500. No attorney was present at the closing, and the closing documents reflected a date for closing that was several days earlier than the actual closing date. This cut off her right to rescind the loan under the Truth-in-Lending Act.

Although she did not want debt consolidation, the new loan included payments for \$4,686 to pay off unsecured debts that the mortgage company pulled from her credit report. She also paid a total of \$3,757 in closing costs and fees, including \$3,110 that was paid to the mortgage company. This was financed over a 15-year loan, so the true cost of credit to her was \$8,208.

Her loan contained a prepayment penalty equal to six months' interest payments if she refinanced within five years of making the loan. The \$30,000 for the promised home improvement work was released to the contractor a few days after closing and before the work was started. The work was never completed.

► An elderly man unable to read or write and with a history of mental illness purchased a modest home in 1977 with much assistance from friends and family. His only income was \$756 a month in Social Security Disability and his daughter was his representative payee because the Social Security Administration had deemed him incapable of handling his own funds. He owed only \$4,800 on his home when he was approached by a contractor who talked him into some home improvements. The contractor steered him to a lender who lent him \$34,691 at 12.81 percent interest over 15 years, resulting in total payments of \$78,789. The loan was closed without an attorney present and despite the fact that the borrower had severely diminished capacity.

As a part of the loan, he was sold a single-premium life insurance policy for five years with a death benefit of \$5,000. The premium of \$1,378 was paid from the proceeds of the loan. Since the premium was financed at 12.8 percent interest over 15 years as a part of the loan, the total cost of the policy was \$3,106. The man also had a stiff prepayment penalty if he refinanced within the first five years of the loan. Most of the home improvement work was either not done or performed in a shoddy manner. The contractor was paid over \$22,000, and yet the actual value of the work was estimated to be only \$5,000 to \$7,000.

The monthly note, which does not include taxes and insurance, is more than half the home owner's income. He was unable to keep up the payments and faced foreclosure when a judge issued an injunction to stop the foreclosure.

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And lenders must give borrowers with high-cost loans a 12-point, bold-face warning that they are about to agree to a high-cost loan that may be disadvantageous to them. Borrowers must also be given notice with high-cost loans advising them to seek credit counseling.

Three other important provisions of the new law apply to all mortgage loans.

The first provision is the right to cure. A borrower must now be given a notice of default and his right to cure the default at least 30 days before a foreclosure is initiated and can incur no attorney's fees during that period. A borrower may cure the default by paying the past-due indebtedness and any

reasonable fees up to three days before foreclosure. This provides an important new protection for Tennessee consumers.

The second provision is assignee liability. Secondary lenders are liable to borrowers for any violations of this law unless they can show they had reasonable procedures to ensure that they did not acquire loans that violate the act.

The third provision relates to enforcement. A borrower may bring a civil action to enforce the law within three years of the date he should reasonably have discovered the violation. For intentional violations, a borrower may recover actual damages and costs; and for willful or intentional violations, the borrower may recover all finance charges

and fees paid. The borrower may also receive punitive damages if the violations are malicious and reckless.

The Affect on Tennesseans

Memphis is consistently ranked in the top 10 metro areas with the highest foreclosure rates. That could change when the new law goes into effect next year.

"We have the opportunity to reduce that foreclosure rate and create more stable

neighborhoods," says Beth Dixon of the RISE Foundation and a member of the Memphis and Shelby County Anti-Predatory Lending Coalition.

It is estimated that this law will save Tennessee home owners millions of dollars a year in unreasonable fees.

Information for this article was provided by Memphis Area Legal Services.



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