Predatory Lending and Homeownership

Predatory or “subprime” lending in the early 2000’s led to the “burst” of the housing bubble and the recession of 2008-2012. Banks and mortgage brokers that were not well regulated gave out risky mortgages with high or adjustable interest rates, fees for paying early, and other difficult terms. Many borrowers couldn’t keep up with the payments and ended up losing their homes. Borrowers of color were steered to subprime mortgages and ended up in foreclosure at higher rates than white borrowers.

Home ownership went down, and because many mortgages were sold to investors, the original lenders and brokers didn’t worry much about whether people could afford the loans. New rules, prosecutions by state attorneys general, fines and the creation of the U.S. Consumer Financial Protection Bureau have reduced the problem although mortgages are not as easy to get as they were twenty years ago.

What is a Predatory Loan?

A predatory loan is an unfair or abusive loan with terms that make it hard for borrowers to succeed. These loans might allow "interest-only" payments, meaning the loan itself is never paid off. They can also have adjustable interest rates that can go up each year, a "prepayment" penalty that stops the borrower from refinancing early, high fees, large balloon payments, or unrealistically high property values. Any of these loan/mortgage terms can make it impossible for the homeowner to pay, refinance, or even sell the property for what they owe. In the early 2000’s some lenders offered 80/20 loans (one mortgage for 80% of the price and a second mortgage for the other 20%, so no down payment) or the infamous NINJA loans (No Income No Job or Assets).

The worst cases happen when someone refinances their current mortgage in a way that harms them. This might let them take out extra cash ("cash-out refinance") to pay off an old mortgage or other debts, but it often comes with higher interest rates and monthly payments. One possible sign of a predatory loan is that the "closing" of the loan occurs at the borrower's home or a fast-food restaurant with a mortgage "broker" who gets a commission for selling mortgages, often at inflated rates.

Most federally guaranteed mortgages (FHA, Fannie Mae, Freddie Mac, VA or USDA/Rural Housing) have stricter regulations and are less likely to be predatory loans. Closings are usually at the bank or title company.

Mortgage Regulations

The federal Truth in Lending Act (TILA) requires lenders to clearly disclose mortgage costs to consumers. It also requires lenders to consider a borrower's actual ability to pay and their credit risk, instead of just looking at the neighborhood's racial makeup. TILA also makes sure appraisers follow fair standards and stops lenders from paying high fees, like big payments to mortgage brokers. One requirement of TILA is that the lender or servicer (company hired by the lender to send statements, collect payments and handle escrow accounts) should send monthly statements to borrowers that show the outstanding balance, interest rate, payment amounts, fees, etc. Some "open end" mortgage loans (Home Equity Lines of Credit/HELOCs) and reverse mortgages are exempt from many regulations.

RESPA or the Real Estate Settlement Procedures Act applies to most mortgages, although "purchase money" mortgages (taken out to buy the home) and HELOCs have fewer regulations. RESPA requires that lenders provide a "settlement statement" with details on costs before the loan is finalized, or closed. RESPA also sets rules for how mortgage companies must handle loans and payments. For example, if mortgage servicing is transferred, the homeowner must be notified of the transfer so they know where to send payments or get information about the account. Transfers of mortgage ownership must be disclosed according to TILA. In some cases, the notification is made right when the loan papers are signed-the loan will be immediately sold or servicing transferred.

One part of RESPA requires the U.S. Consumer Financial Protection Bureau to create a booklet on home buying to help consumers understand the different parts of a mortgage, mortgage servicing and escrow accounts, etc. https://www.consumerfinance.gov/owning-a-home

The Home Ownership and Equity Protection Act (HOEPA) applies to some very high-cost loans. Since 2014, HOEPA rules apply if the interest rate is 6.5% higher than the average prime rate on a Freddie Mac/Federal Home Loan Mortgage Corp. loan for a first mortgage or 8.5% higher for a manufactured home loan. Under HOEPA, lenders must provide extra disclosures, and there are stronger penalties for breaking the rules. However, HOEPA does not apply to reverse mortgages.

The Equal Credit Opportunity Act and the Fair Housing Act prohibit discrimination based on race, color, national origin, religion, sex, marital status, age, handicap or receipt of public assistance.

Wisconsin law regulates mortgage brokers, loan originators, and mortgage bankers. These rules do not apply to banks, savings and loans, credit unions, and similar financial institutions but state that they apply to "persons" who find loans for consumers for a commission/fee. Violations for not keeping paperwork or making false claims can be reported to the Wisconsin Dept. of Financial Institutions. https://dfi.wi.gov/Pages/FinancialServices/MortgageBanking/GeneralInformation.aspx

Solutions for Predatory Mortgages

It is easier to avoid getting a predatory mortgage than to get out of one, so take advantage of homebuyer education classes or articles, ask questions and look for other lending options. Some TILA and RESPA violations may be raised as defenses in foreclosure.

Certain violations of TILA allow a borrower to "rescind" a mortgage, basically canceling the lien on the home while the borrower pays only the remaining principal amount. The right to rescind only applies to mortgages taken out to refinance or improve the home and is available for three business days after the loan/mortgage closing or up to three years for certain disclosure violations. There are penalties for other violations (RESPA and HOEPA) including attorneys' fees, costs and actual damages.

Refinancing is one way to deal with a predatory loan (by paying it off if possible); violations can be reported to the U.S. Consumer Financial Protection Bureau: https://www.consumerfinance.gov However, to use some of the more powerful solutions for a predatory loan, consulting with a consumer/banking attorney is recommended.

Last updated on March 21, 2025.

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